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COMMERCIAL and INDUSTRIAL LAW

By

ARUN KUMAR SEN, M.A. (Cal.), M.Sc. (Econ., Lond.),
Barrister-at-Law , Principal, City College, Commerce, Calcutta

AND

JITENDRA KUMAR MITRA, M.A., LL.B.,
*'dvocate, Calcutta High Court , Lecturer, University College of Arts and
Commerce, Calcutta University , formerly Professor of Commercial
Law and Economics, City College, Commerce, Calcutta*



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VOLUME ONE
COMMERCIAL LAW

BOOK I

INTRODUCTION

DEFINITION OF LAW

The term Law is used to denote rules of conduct enforced by the State. People living in an organised society have to follow certain common rules, otherwise peaceful living is impossible. It is the function of the State to enforce these rules.

According to Holland,¹ Law is, “a rule of external human action enforced by the sovereign political authority”. From this definition it follows that there are three essential characteristics of law.

1. Law is a rule relating to the *actions* of human beings.
2. Law attempts to regulate the *external actions* of human beings, not their minds.
3. Law is enforced by the State.

Woodrow Wilson² defines Law as follows : “Law is that portion of the established habit and thought of mankind which has gained distinct and formal recognition in the shape of uniform rules backed by the ‘authority and power of the government’”. This definition is practically the same as that of Holland.

Rules regarding human conduct are necessary for peaceful living as well as for progress and development. Anson³ observes as follows : “The object of Law is Order, and the result of Order is that men are enabled to look ahead with some sort of security as to the future. Although human action cannot be reduced to the uniformities of nature, men have yet endeavoured to reproduce by Law something approaching to this uniformity.”

DEFINITION OF COMMERCIAL LAW

The laws of a country relate to many different subjects. They include rules regarding inheritance and transfer of property, relationship between persons, crimes and their punishment, matters relating

¹ Holland, *Jurisprudence*.

² Woodrow Wilson, *The State*.

³ Anson, *Law of Contract*.

to voting and election, as well as matters relating to industry, trade and commerce. The term Commercial Law or Mercantile Law is used to include only the last of the aforesaid subjects, viz., rules relating to industry, trade, and commerce.

A *commercial suit* is defined by the rules of the Calcutta High Court as follows : "Commercial Suits include suits arising out of the ordinary transactions of merchants, bankers, and traders; amongst others those relating to the construction of mercantile documents, export and import of merchandise, affreightment, carriage of goods by land, insurance, banking; mercantile agency and mercantile usages, and debts arising out of such transactions."

The Calcutta High Court's definition of "commercial suit" is taken from English rules of civil procedure. According to this definition, a suit between merchants, bankers, and traders, relating to mercantile transactions is a commercial suit. It follows that all laws which must be referred to in order to decide such suits come within the scope of commercial law. Commercial law or mercantile law may therefore be defined as *that part of law which regulates the transactions of the mercantile community*.

The scope of commercial law is fairly large. It includes the laws relating to contract, partnership, negotiable instruments, sale of goods, companies etc.

It must be noted that there is no clear cut line of demarcation between commercial law and other branches of law, nor is there any conflict or contradiction between them. The law of contract, which is a very important part of commercial law, is applicable not only to merchants and bankers but also to other persons. When a merchant files a suit in a court of law the procedure is not materially different from that of other suits. When a trader commits an offence he is punishable under the criminal law exactly in the same way as any other person. The subjects studied under the heading of commercial law do not form a comprehensive code dealing with all aspects of mercantile activity. Commercial law deals with only those parts of law which are of special importance to the mercantile community. The same laws are applicable to other citizens under appropriate circumstances.

SOURCES OF INDIAN COMMERCIAL LAW

The commercial law of India is based upon English mercantile law and Indian mercantile usages, modified and adapted by statutes of the Indian legislature and judicial decisions.

Prior to 1872, English courts in India used to decide disputes

by applying the personal law of the parties to the suit. Where both parties were Hindus, Hindu law and Hindu customs were applied. Where one party was a Hindu while the other was a non-Hindu, the personal law of the defendant was applied. Where the relevant personal law contained no rule relating to the matter in dispute, the judges used to apply rules of English law because they considered such rules to be based upon equity and good conscience. In this way rules of English law came to be gradually incorporated into Indian judicial decisions and became part of Indian law. In 1872, the Indian Contract Act was passed. This act is more or less a codification of the English Common Law rules on the subject of contract. Since then a large number of statutes have been passed relating to matters coming within the scope of commercial law. As examples, the following Acts may be referred to : Negotiable Instruments Act (1887); Companies Act (1913 and 1956); Partnership Act (1932); Sale of Goods Act (1930). These Indian statutes are based upon the corresponding English statutes.

The sources from which the rules of Indian Commercial Law have been derived are stated below.

1. English Mercantile Law. Many rules of English Mercantile Law have been incorporated into Indian Law through statutes and judicial decisions. English Mercantile Law is itself a mixture of diverse elements. It contains rules originating from the following sources :

- (i) Maritime usages which developed during the 14th and the 15th centuries among merchants trading in the European ports. These usages are known as *Lex Mercatoria*.
- (ii) Rules which developed by custom in England and which constitute what is called the English Common Law.
- (iii) Rules of Roman Law.
- (iv) Rules of Equity, *i.e.* rules which were applied by English Courts of Equity in cases where the common law rules were considered harsh and oppressive.
- (v) Statutes of the British Parliament.

2. Statutes of the Indian Legislatures. The legislature is the main source of law in modern times. In India, the Central and the State legislatures possess law making powers and have exercised their powers extensively. The greater part of Indian commercial law is statutory.

3. Judicial Decisions. Judges interpret and explain statutes. Rules of equity and good conscience are incorporated into law through judicial decisions. Whenever the law is silent on a point, the judge

has to decide the case according to his idea of what is equitable. Prior to 1947, the Judicial Committee of the Privy Council of Great Britain was the final court of appeal for Indian cases and its decisions were binding on Indian courts. After the attainment of independence, the Supreme Court of India is the final court of appeal. But decisions of the superior English courts like the Courts of Appeal, Privy Council, and the House of Lords, are frequently referred to as precedents which might be followed in interpreting Indian statutes and as rules of equity and good conscience.

4. Custom and Usages. A customary rule is binding where it is ancient, reasonable, and not opposed to any statutory rule. A custom becomes legally recognised when it is accepted by a court and is incorporated in a judicial decision.

BOOK II

THE LAW OF CONTRACT

✓ The Law of Contract deals with agreements which can be enforced through courts of law.

The Law of Contract is the most important part of commercial law because all commercial transactions start from an agreement between two or more persons.

According to Salmond¹, a contract is “an agreement creating and defining obligations between the parties”. According to Sir William Anson², “A contract is an agreement enforceable at law made between two or more persons, by which rights are acquired by one or more to acts or forbearances on the part of the other or others”.

The object of the Law of Contract is to introduce definiteness in commercial and other transactions.

Sir William Anson observes as follows : “As the law relating to property had its origin in the attempt to ensure that what a man has lawfully acquired he shall retain, so the law of contract is intended to ensure that what a man has been led to expect shall come to pass; and that what has been promised to him shall be performed.”

The Indian Contract Act of 1872 (Act IX of 1872) lays down certain general rules regarding contracts. The Act is not exhaustive. There are other Acts relating to particular types of contracts, *e.g.* the Negotiable Instruments Act, the Transfer of Property Act, etc. The Contract Act does not affect any usage or custom of trade, or any incident of any contract not inconsistent with the provisions of the Act.—Sec. 1.

¹ Salmond, *Jurisprudence*.

² Anson, *Law of Contract*.

CHAPTER 1

THE NATURE OF A CONTRACT AND ITS ESSENTIAL ELEMENTS

Section 2 (h) of the Indian Contract Act provides that, "An agreement enforceable by law is a contract".

An agreement comes into existence whenever two or more persons promise to do or not to do something. "Every promise and every set of promises, forming the consideration for each other, is an agreement."—Sec. 2(e). Some agreements cannot be enforced through the courts of law, *e.g.* an agreement to play cards or go to a cinema. An agreement, which can be enforced through the courts of law, is called a *contract*.

➤ **The Essential Elements of a Contract.** An agreement becomes enforceable by law when it fulfils certain conditions. These conditions, which may be called the Essential Elements of a Contract, are stated below.

1. *Offer and Acceptance.* There must be a lawful offer by one party and a lawful acceptance of the offer by the other party or parties. The adjective "lawful" implies that the offer and acceptance must conform to the rules laid down in the Indian Contract Act regarding offer and acceptance.

2. *Legal Relationship.* There must be an intention (among the parties) that the agreement shall result in or create legal relations. An agreement to dine at a friend's house is not an agreement intended to create legal relations and is not a contract. But an agreement to buy and sell goods or an agreement to marry, are agreements intended to create some legal relationship and are therefore contracts, provided the other essential elements are present.

3. *Lawful Consideration.* Subject to certain exceptions, an agreement is legally enforceable only when each of the parties to it gives something and gets something. An agreement to do something for nothing is usually not enforceable by law. The something given or obtained is called Consideration. The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. Consideration may be past (something already done or not done). It may also be present or future.

But only those considerations are valid which are "lawful" (what is meant by 'lawful consideration' is discussed in Ch. 8).

4. *Capacity*. The parties to an agreement must be legally capable of entering into an agreement, otherwise it cannot be enforced by a court of law. Want of capacity arises from minority, lunacy, idiocy, drunkenness, and similar other factors. If any of the parties to the agreement suffers from any such disability, the agreement is not enforceable by law, except in some special cases.

5. *Free Consent*. In order to be enforceable, an agreement must be based on the free consent of all the parties. There is absence of genuine consent if the agreement is induced by coercion, undue influence, mistake, misrepresentation, and fraud. An agreement vitiated by any of these factors cannot be enforced by the party guilty of coercion, undue influence etc. The other party (the aggrieved party) can enforce it, subject to rules laid down in the Act.

6. *Legality of the object*. The object for which the agreement has been entered into must not be illegal, or immoral or opposed to public policy.

7. *Writing and registration*. A contract may be ~~be~~ oral. But the law lays down certain special cases where the agreement, to be valid, must be in writing and registered, e.g. sale of immovable property.

8. *Certainty*. The agreement must not be vague. It must be possible to ascertain the meaning of the agreement, for otherwise it cannot be enforced.

9. *Possibility of performance*. The agreement must be capable of being performed. A promise to do an impossible thing cannot be enforced.

The elements mentioned above must *all* be present. (If any one of them is absent the agreement does not become a contract. An agreement which fulfils all the essential elements is enforceable by law and is called a contract! From this it follows that, *every contract is an agreement but all agreements are not contracts.*)

Every contract gives rise to certain "obligations or duties on the part of the contracting parties. The obligations are enforced by the courts.

The Indian Contract Act contains rules regarding each of the elements mentioned above. These rules are discussed in the subsequent chapters.

EXERCISES

1. "All contracts are agreements but all agreements are not contracts". Explain. (C.U. '46).

2. What are the essential elements of a contract? (C.A., May, 1949).

CHAPTER 2

OFFER AND ACCEPTANCE

All contracts are made by the process of a lawful offer by one party and the lawful acceptance of the offer by the other party. *X* says to *Y*, "Will you buy my house for Rs. 50,000?" This is an offer. If *Y* says, "Yes", the offer is accepted and a contract is formed.

✓ An "offer" involves the making of a "proposal". The term "proposal" is defined in the Contract Act as follows: "When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal."—Sec. 2(a).

"When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise."—Sec. 2(b).

"The person making the proposal is called the 'promisor' and the person accepting the proposal is called the 'promisee'."—Sec. 2(c).

A proposal is also called an "offer". The promisor or the person making the offer is called the "offeror". The person to whom the offer is made is called the "offeree".

Examples of offer and acceptance :

- (i) *A* offers to sell his motor car to *B* at the price of Rs. 5,000. This is a proposal. *A* is the promisor or the offeror. *B* is the offeree. If *B* agrees to buy the car at the price stated, *B* becomes the promisee or the acceptor. There is a contract.
- (ii) *A* puts up a notice offering to pay a reward of Rs. 5 to any student who finds out and returns a book lost in the college. *B*, a student, reads the notice and then finds and brings the book to *A*. *A*'s notice is an offer and *B* is the acceptor. There is a contract.
- (iii) A transport company runs tramway cars along the streets. This is an offer by the company to carry passengers at the scheduled fares. The offer is accepted when a passenger gets up on a tram with the intention of becoming a passenger.

✓ **Rules regarding offer.** The Contract Act contains various rules regarding offers or proposals. They can be summed up as follows :

1. *An offer may be express or may be implied from the circumstances.* An offer may be made in two ways : (i) by words,

spoken or written and (ii) by conduct. When an offer is made by stating so in words or in writing, it is called an Express offer. When an offer is implied from the conduct of a person, it is called an Implied offer.) Examples (i) and (ii) above are cases of express offer. Example (iii) is a case of an implied offer.

"In so far as the proposal or acceptance of any promise is made in words, the promise is said to be express. In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied."—Sec. 9.

2. *An offer may be made to a definite person; to some definite class of persons; or to the world at large.* Example (i) is an offer to a definite person; example (ii) is an offer to a definite class of persons; and example (iii) is an offer to the world at large.

3. *The terms of the offer must be certain.* A says to B, "I will give you some money if you marry C". This is not an offer which can be accepted, because the amount of money to be paid is not certain.

4. *A mere statement of intention is not an offer.* Price lists and catalogues, and enquiries for customers are merely statements of intention. They are not regarded as offers but as invitation to others to make offers. An advertisement in a newspaper or elsewhere may be so worded that it amounts to an offer. But ordinarily an advertisement is considered to be an invitation to make offers.

Examples .

- ✱ (i) A label on an article in a shopkeeper's showcase stating 'price Rs. 5' is only an expression of an intention to sell the article at Rs. 5. It is not an offer to the world at large which can be accepted by anybody. The intending purchaser who wishes to buy the article is the proposer. The shopkeeper may or may not accept the proposal. The same rule applies to price-lists and catalogues.
- ✱ (ii) An newspaper advertisement inviting applications for a job or inviting tenders for some work is not an offer. It is only an invitation to make offers. The applicants who reply to the advertisement are the proposers or offerors. The advertiser is free to accept any one of the applications.
- (iii) H telegraphed to F asking the latter to inform him whether he would sell Whiteacre and if so at what price. F informed H that the lowest price was £900 but did not say that he was willing to sell at that price. H telegraphed that he would buy at that price. F gave no reply to the telegram. Held there was no contract because neither the question of H nor the reply of F constituted an offer. *Harvey v. Facey*.

5. *An offer must be communicated to the offeree.* A person cannot accept an offer unless he knows of the existence of the offer. *A* offers a reward to anyone who returns his lost dog. *B* finding the dog brings it to *A* without having heard of the offer. Held, he was not entitled to the reward. *Fitch v. Snedaker*.² In this case it was argued that a man cannot accept an offer without intending to do so, and he cannot intend to accept an offer of which he was ignorant. In *Lalman v. Gauri Dut*³ *G* sent his servant *L* in search of his missing nephew. Subsequently *G* announced a reward for information concerning the boy. *L* brought back the missing boy, without having known of the reward. Held, there was no contract between *L* and *G* and the reward cannot be claimed.

How is an offer to be communicated? An offer may be communicated to the offeree or offerees by word of mouth, by writing, or by conduct. A written offer may be contained in a letter or a telegram. A circular or advertisement or a notice may be written in such a language that it amounts to an offer. A tramway car and a bus going along a street and picking up passengers are examples of offers by conduct.

Section 3 of the Contract Act states as follows: "The communication of proposals, the acceptance of proposals, and the revocation of proposals and acceptances, respectively, are deemed to be made by any act or omission of the party proposing, accepting or revoking by which he intends to communicate such proposal, acceptance or revocation or which has the effect of communicating it."

Section 4 states: "The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made."

6. *An offer may be conditional.* An offer may be made subject to certain conditions. In such cases, the conditions must be clearly communicated to the offeree. If a person accepts an offer without knowledge of the conditions, the offeror cannot claim fulfilment of the conditions. But if the conditions are clearly written or expressed and should have been known to the offeree, he cannot plead ignorance of the conditions.

Examples :

- (i) *X* agreed to buy goods from *Y* and signed an order form given by *Y* containing a number of clauses in small print, without reading them. Held, the clauses were binding on *X*. *L'Estrange v. Graucob Ltd*.⁴

² 30 N.Y. 248

³ 11 A.L.J. 489

⁴ (1934) 2 K.B. 394

- (ii) *T*, who could not read, took an excursion ticket on the railway. On the front of the ticket was printed "for conditions see back". One of the conditions was that the railway company would not be liable for personal injuries to passengers. *T* was injured by a railway accident. Held, *T* was bound by the conditions and could not recover any damages. *Thomson v. L. M. & S. Rly.*⁶
- (iii) *R* booked her passage on a ship and received a ticket folded in such a way that no writing was visible. On the ticket were printed certain conditions in small type, one of which was that the shipowners' liability was limited to \$100. *R* knew that there was printing on the ticket but did not know that the printing related to conditions of the contract. Held, *R* was not bound by the conditions as she did not know of their existence, and having regard to the smallness of the type in which they were printed, the absence of calling of attention to them, the shipowner had not given reasonable notice of them. *Richardson v. Rowntree.*⁷

From the above cases it follows that if there are special conditions in an offer, they must be stated in such a manner that the attention of the offeree is drawn to them. If this is done, he is bound by the conditions even if he does not actually know what they are.

ACCEPTANCE

Who can accept? An offer can be accepted only by the person or persons for whom the offer is intended. An offer made to a particular person can only be accepted by him because he is the only person intended to accept. An offer made to a class of persons can be accepted by any member of that class. An offer made to the world at large can be accepted by any person whatsoever. *A* sold his business to *B* without disclosing the fact to his customers. *C* sent an order for goods to *A* by name. *B* received it and sent a letter of acceptance. Held, there was no contract between *B* and *C* because *C* never made any offer to *B*. *Boulton v. Jones.*¹

Rules regarding acceptance. The acceptance of an offer to be legally effective must satisfy the following requirements :

1. *It must be an absolute and unqualified acceptance of all the terms of the offer.*—Sec. 7 (1). If there is any variation, even on an unimportant point, between the terms of the offer and the terms of the acceptance, there is no contract.

⁶ (1930) 1 K.B. 41

⁷ (1894) A.C. 217

¹ (1857) E.R. 232

Examples :

- (i) M offered land to N at £280. N replied accepting and enclosing £80 and promising to pay the balance by monthly instalments of £50. Held, there was no contract, as there was no unqualified acceptance. *Neale v. Merrett*.¹
- (ii) A offered to buy B's mare on B giving a guarantee that the mare was *quiet in harness*. B guaranteed that the mare was "*quiet in double harness*". Held, no acceptance. *Jordan v. Norton*.²
- (iii) X offered to sell his house for Rs. 12,000. Y said, "accepted for Rs. 10,000". This is not an acceptance but a counter offer.

2. *The acceptance must be expressed in some usual or reasonable manner.*—Sec. 7(2). The offeree may express his acceptance by word of mouth or by post or telegram. These are the usual methods of communicating acceptance to the offeror.

An offer may also be accepted by conduct. If the offeree does what the offeror wants him to do, there is acceptance of the offer by conduct.) Section 8 of the Act states that, "Performance of the conditions of a proposal or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, is an acceptance of the proposal".

Examples :

- (i) A offers to buy B's bicycle at Rs. 50. B may accept this offer by stating so orally or by writing a letter or by sending a telegram to that effect.
- (ii) A offers to pay B Rs. 50 if he would jump from the first floor of a house to the ground floor. B jumps down from the first floor to the ground floor. The offer has been accepted by conduct.
- (iii) A company offered £100 to anyone who contacted influenza after using their smoke ball. Mrs. Carlill used the smoke ball but nevertheless got influenza. She claimed the reward. The company objected, that she should have notified them of her acceptance of the offer. Held, the use of the smoke ball by Mrs. Carlill constituted acceptance of the offer by conduct, and no formal notice of acceptance was necessary. *Carlill v. Carbolic Smoke Ball Company*.³
- (iv) A widow invited her niece to stay with her in her residence and promised to settle on her a particular immovable property. The niece stayed with her in her residence till her death. Held, (by the Privy Council) that the niece was entitled to the property because she had accepted the aunt's offer by going to her residence and staying with her as desired. *V. Rao v. A. Rao*.⁴

¹ (1930) W.N. 189.

² 7 L.J. Ex. 281.

³ (1893) 1 Q.B. 256

⁴ (1916) 39 Mad 509

~~A~~ *Mental acceptance or uncommunicated assent does not result in a contract.* No contract is formed if the offeree remains silent and does nothing to show that he has accepted the offer. Acceptance must be communicated to the offeror or shown by conduct.

Examples :

- (i) F offered to buy B's horse for £30, saying "If I hear no more about him I shall consider the horse as mine at £30." B did not reply. Held, there was no contract because there was no communication of acceptance. Mental acceptance or uncommunicated assent does not result in a contract. Felt-house v. Bindley.³
- (ii) A person received an offer by letter; he wrote on the letter "accepted", put the letter in his drawer and forgot all about it. Held, there was no contract because the other party was not informed. Brogden v. Metropolitan Rly. Co.⁴

4. Where the promisor prescribes a particular mode of acceptance, the offeree must follow that particular mode of acceptance. For example if the offeror says, "acceptance to be sent by telegram", the offeree must send a telegram. If the offeree fails to follow the prescribed mode of acceptance, the proposer may, within a reasonable time after the acceptance is communicated to him, insist that the proposal be accepted in the prescribed manner and not otherwise. But if the proposer does not insist upon it, he accepts the acceptance as actually communicated.—Sec. 7(2). Thus, under the Indian law the proposer has the option of waiving compliance with the prescribed mode of acceptance.

Example :

X offers to buy a certain quantity of coal from Y at a certain price and asks Y to send a telegram if he accepts. Y writes a letter accepting the offer. X may insist on a telegram from Y; but if X does not so insist, the acceptance is good.

5. Section 4 of the Contract Act lays down that the communication of an acceptance is complete,—as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of the acceptor; and as against the acceptor, when it comes to the knowledge of the proposer.

Example :

B accepts A's proposal by a letter sent by post. The communication of acceptance is complete,—as against A, when the letter is posted; as against B, when the letter is received by A.

³ (1862) 11 C.B.N.S. 869

⁴ (1877) A.C. 666

6. *The acceptance must be made while the offer is in force* i.e. before the offer has been revoked or the offer has lapsed. How an offer is revoked is described below.

Offer and Acceptance by Post. An offer may be made by post. An offer may also be accepted by post, if there is no other mode of acceptance specially prescribed by the proposer. When a proposal is made through the post, the post office is by implication agent of the proposer. Therefore a letter of acceptance duly addressed and posted is sufficient acceptance even though the letter does not actually reach the proposer. The letter must be correctly addressed. The letter must be actually posted. It is not enough to put it to somebody to post.

Example :

G applied for shares in a company. A letter of allotment was posted but the letter did not reach G. Held there was a binding contract and G was a shareholder of the company. Household Fire Insurance Co. v. Grant.¹

Options. An option is a conditional contract to do something. Suppose that A, the owner of a house, agrees in consideration of Rs. 200, to give B an option to buy the house within six months at a certain price. This is a contract binding upon A to allow B to purchase the house at the agreed price at any time within six months. A promise to keep an offer open to acceptance for a certain time is not binding on the proposer unless there is a consideration separately given for that promise, as in the example given above.

Standing Contracts. Open Proposals. Contracts for the supply of goods over a period of time are sometimes so worded that the buyer has an option as regards the quantity to be purchased and the time of purchase. Such contracts are called "Standing Contracts" or "Open Proposals".

Example :

P signed a tender addressed to the London County Council, agreeing, on acceptance, to supply all the goods specified in the schedule, to the extent ordered. The tender was accepted but the L.C.C. did not order any goods. Held, the L.C.C. was not bound to order any goods, but if it did so, P was bound to deliver the goods as and when ordered. *Percival Ltd. v. L.C.C.*²

In such cases as above, a contract comes into existence when a definite quantity is ordered. *Bengal Coal Co. v. Wadia.*³

¹ (1877) 4 Ex. D. 216

² (1918) 87 L.J.K.B. 677

³ (1900) 24 Bom 97

CHAPTER 4

CONSIDERATION

Definition of Consideration. Consideration is an essential element of a contract. An agreement is not valid as a contract unless each party to the agreement gets something. This "something" is called consideration.

In the English case, *Currie v. Misa*¹, consideration was defined, "some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other."

Section 2(d) of the Contract Act defines consideration as follows: "When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."

Examples

- (i) A agrees to sell a house to B for Rs. 20,000. For A's promise, the consideration is Rs. 20,000. For B's promise, the consideration is the house.
- (ii) H engages Q as a clerk in his office for Rs. 100 a month. The monthly wage is the consideration received by Q; the services of Q constitute the consideration received by H.
- (iii) X promises not to file a suit against Y if Y pays him Rs. 100 by a fixed date. The forbearance of X is the consideration for Y's payment.

Types of Consideration. Consideration may be classified into three types, as follows:

1. **Past consideration**—When the consideration of one party was given before the date of the promise, it is said to be past. Suppose that A does some work for B in the month of January. In February B promises to compensate him. The consideration of A is past consideration. Under English law past consideration is no consideration and a contract based on past consideration is void. But under Indian law a past consideration is good consideration because the definition of consideration in Section 2(d) includes the words "has done or abstained from doing."

¹ (1875) 10 Ex 153.

2. *Present consideration*—Consideration which moves simultaneously with the promise is called Present Consideration or Executed Consideration. A buys an article from a shop and pays the price immediately. The consideration moving from A is present or executed consideration.

3. *Future consideration*—When the consideration is to move at a future date it is called Future Consideration or Executory Consideration. In a contract the consideration may be executory on both sides. A promise may support a promise. Thus a promise to pay money at a future date for goods to be delivered at a future date is a valid contract.

Rules regarding Consideration. The following general rules may laid down regarding consideration :

1. *Desire of the promisor is essential.* The act done or detriment suffered by the promisee must have been done or suffered at the desire of the promisor. An act done without any request is a voluntary act and does not come within the definition of consideration.

Examples :

- (i) A sees B's house on fire and helps in extinguishing it. He cannot demand payment for his services because B never asked him to come and help.
- (ii) The collector of a district asked X to spend some money on the improvement of a market and he did so. X cannot demand payment from the shopkeepers using the market for having improved the market. *Durga Prasad v Baldeo*²
- (iii) A promised to pay B some money by a letter. B showed the letter to C who thereupon consented to the marriage of her daughter with B. C cannot force A to pay the money to B because there is no connection between the marriage and the promise to pay. *Dashwood v. Jermyn*.³

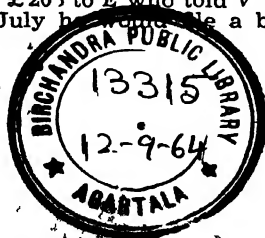
2. *The consideration must be real.* The consideration must have some value in the eye of law. It must not be sham or illusory.

Examples :

- (i) A promises for no consideration to give B Rs. 1,000 This is a void agreement. No consideration, no contract.
- (ii) A promises to supply B one tola of gold brought from the sun. The consideration is sham and illusory and there is no contract.
- (iii) V owed £203 to E who told V that if the money was not paid by 7th July he would file a bankruptcy petition against V.

² 3 All 221.

³ 12 Ch. D. 776.




Thereupon V promised to pay the money before 12 o'clock on 8th July and E agreed not to file the petition before that time. Held, there was no consideration for E's promise. *Vanburgen v. St. Edmunds Properties Ltd.*⁴

Example (iii) above illustrates the rule that a promise to do what one is already bound to do (whether under the law or under an existing contract) confers no additional benefit and is of no value. The consideration is unreal. A promise to pay an existing debt punctually if the creditor gives a discount is without consideration and the discount cannot be enforced.

But a promise made to a stranger to perform an existing contract, is enforceable because the promisor undertakes a new obligation upon himself which can be enforced by the stranger. A wrote to his nephew B, promising to pay him an annuity of £150 in consideration of his marrying C. B was already engaged to marry C. Held, the fulfilment of B's contract with C was consideration to support A's promise to pay the annuity. *Shadwell v. Shadwell*.⁵

*The case of promise to charities. A promise to make a contribution to charity is not enforceable because it is without consideration. A hatchitta executed by the promisor for arrears of contribution is no more than a repetition of a voluntary promise and is not enforceable. *Jamuna v. Ram*.⁶

† In *Kedarnath v. Gorie Mahomed*⁷ the defendant promised to pay Rs. 1,000 towards the construction of the Howrah Town Hall and the trustees of the Town Hall, on the basis of this and similar other promises, engaged contractors for building the hall. The defendant subsequently refused to pay the money and a suit was filed against him. The Calcutta High Court held that ordinarily subscriptions to charitable objects were irrecoverable but if the promisors knew the purposes of the charity and also knew that on the strength of their promises obligations would be undertaken to third parties (the building contractors in this case) the promise is enforceable. This decision is in direct conflict with various English decisions on similar facts. In many subsequent cases on this point in Indian courts, the Calcutta decision has not been followed.

 Consideration need not be adequate. Section 25 (explanation 2) provides that, "An agreement to which the consent of the party is freely given is not void merely because the consideration is

⁴ (1933) 2 K.B. 223

⁵ (1860) 9 C.B.N.S. 159.

⁶ 189 I.C. 396.

⁷ 14 Cal. 64.

inadequate; but the inadequacy of the consideration may be taken into account by the court in determining the question whether the consent of the promisor was freely given." The reason behind this rule is that it is impossible for the court to decide what is adequate consideration. The parties to the contract must decide the quantum of consideration and, if consent was freely given, the court will enforce the agreement.

Examples :

- (i) A agrees to sell a horse worth Rs. 1,000 for Rs. 10. A's consent to the agreement was freely given. The agreement is a contract notwithstanding the inadequacy of the consideration.
- (ii) A promises to B to sell land in Calcutta at Rs. 10 per cottah. The agreement is valid provided the consent of A was freely given.
- (iii) A promised to pay certain bills if B would hand over a guarantee to him. B handed the guarantee over but it turned out to be unenforceable. Held, as A had received what he had asked for, there was consideration for his promise and the contract was binding. *Haigh v. Brookes*.⁸
- (iv) A files a suit against B for Rs. 5,000. Subsequently he agrees to withdraw the suit on payment of Rs. 3,000. The agreement is a contract. The withdrawal of a suit is valuable consideration so as to support the promise to pay money.

4. *The consideration must not be illegal, immoral, or opposed to public policy.* If either the consideration or the object of the agreement is illegal, the agreement cannot be enforced. The same principle applies if the consideration is immoral or opposed to public policy. [See Sec. 23 and Ch. 8 below for examples of such agreements.]

5. *The consideration may be present, past, or future.* This follows from the definition of consideration given in the Act.

X// 6. *Consideration may move from the promisee or from any other person.* A person granted some properties to his wife C directing her at the same time to pay an annual allowance to his brother R. C also entered into an agreement with R promising to pay the allowance to R. This agreement can be enforced by R even though no part of the consideration received by C moved from R. *Chinnaya v. Ramaya*.⁹ A stranger to the consideration can sue to enforce the contract, though a stranger to the contract cannot. In England, a stranger to the consideration cannot sue on the contract.

⁸ (1839) A & E 309.

⁹ 4 Mad 137

~~DIFFERENCES~~ BETWEEN ENGLISH AND INDIAN LAW REGARDING CONSIDERATION

There are certain differences between the English and the Indian law relating to consideration. The differences are enumerated below.

1. In England, a distinction is made between Formal Contracts and Simple Contracts. A Formal Contract is one which is (a) in writing or printed, (b) signed, (c) sealed, and (d) delivered to the other party. All other contracts are called Simple Contracts. Under English law, Formal Contracts do not require any consideration but Simple Contracts must be supported by some consideration. Formal Contracts are also called Contracts Under Seal and Specialty Contracts. Simple Contracts are also called Parol Contracts.

The Indian law of contract does not make any distinction between Formal Contracts and Simple Contracts. In India, excepting the few cases mentioned below, all contracts require consideration.

2. Under English law past consideration is no consideration. Under Indian law past consideration is good consideration.

3. Under English law, consideration must move from the promisee. Under Indian law it may move from the promisee or any other person.

~~NO~~ NO CONSIDERATION NO CONTRACT" EXCEPTIONS TO THE RULE

Consideration is essential for the validity of a contract. "A promise without consideration is a gift; one made for a consideration is a bargain".—Salmond and Winfield: *Law of Contracts*.

"A bargain without consideration is a contradiction in terms and cannot exist."—Lord Loughborough.

A promise without consideration is a gratuitous undertaking and however sacred or binding in honour it may be, cannot create a legal obligation. Under Roman law an agreement without consideration was called a *nudum pactum* and was unenforceable. Under English law simple contracts must be supported by consideration but specialty contracts require no consideration. Under Indian law the presence of consideration is, as a rule, essential to the validity of contracts. But there are a few exceptional cases where a contract is enforceable even though there is no consideration. They are as follows :

1. An agreement made without consideration is valid if, "it is expressed in writing and registered under the law for the time being in force for the registration of documents, and is made on account

of natural love and affection between parties standing in a near relation to each other.”—Sec. 25(1).

An agreement without consideration is valid under Section 25(1) only if the following requirements are complied with :

- (i) The agreement is made by a written document.
- (ii) The document is registered according to the law relating to registration in force at the time.
- (iii) The agreement is made on account of natural love and affection.
- (iv) The parties to the agreement stand in a near relation to each other.

Examples :

- (i) A, for natural love and affection, promises to give his son B, Rs. 1000. A puts his promise to B in writing and registers it. This is a contract. [Illustration (b) to Section 25.]
- (ii) An agreement is entered into by a husband with his wife, during the pendency of divorce proceedings between them, whereby the husband promised to give some property to the wife. The agreement is void because, under the circumstances, there is no ‘natural love and affection between the parties.

2. A promise made without any consideration is valid if, “it is a promise to compensate wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do.”—Sec. 25(2).

Section 25(2) applies when there is a voluntary act by one party and there is a subsequent promise (by the party benefited) to pay compensation to the former. The term ‘voluntarily’ signifies that the act was done, “otherwise than at the desire of the promisor”.

Examples :

- (i) A finds B’s purse and gives it to him. B promises to give A Rs. 50. This is a contract.
- (ii) A supports B’s infant son. B promises to pay A’s expenses in so doing. This is a contract.

3. A promise to pay, wholly or in part, a debt which is barred by the law of limitation can be enforced if the promise is in writing and is signed by the debtor or his authorised agent.—Sec. 25(3). A debt barred by limitation cannot be recovered. Therefore a promise to repay such a debt is, strictly speaking, without any consideration. But nevertheless such a promise can be enforced if the debtor or his authorised agent makes a written and signed promise to repay it.

The debt must be a liquidated or ascertained sum of money and there must be a definite promise to pay. A mere acknowledgment of the debt is not enough.

Example :

A owes B Rs. 1,000 but the debt is barred by the Limitation Act. A signs a written promise to pay B Rs. 500 on account of the debt. This is a contract.

4. No consideration is required to create an agency.—Sec. 185.
5. The rule “no consideration, no contract” does not apply to completed gifts. Explanation 1, to Section 25 states that, “Nothing in this section shall affect the validity, as between the donor and the donee, of any gift actually made.” Thus, if a person gives certain properties to another according to the provisions of the Transfer of Property Act (*i.e.* by a written and registered document) he cannot subsequently demand the property back on the ground that there was no consideration.

CAN A PERSON WHO IS NOT A PARTY TO A CONTRACT SUE UPON IT?

A stranger to a contract, *i.e.* one who is not a party to it, cannot file a suit to enforce it. A contract between A and B cannot be enforced by C. But a stranger to the consideration can sue to enforce it provided he is a party to the contract. A contract between A, B and C whereby A pays money to B for delivering goods to C can be enforced by C although he did not pay any part of the consideration.

There are certain exceptions to the rule that a stranger to the contract cannot sue upon it. They are as follows :

1. An agreement to create a trust can be enforced by the beneficiary. *beneficiary in case of a Trust*
A agrees to transfer certain properties to B to be held by B in trust for the benefit of C. C can enforce the agreement though he was not a party to the agreement.
2. Under certain circumstances a party to a contract can transfer his rights under the contract to third parties. For example, the holder of a bill of exchange can transfer it to any person he wishes. In such cases the transferee or the assignee can sue on the contract even though he was not a party to it originally. Assignment may occur through operation of law. For example, when a person becomes insolvent all his properties and rights vest in the official assignee who can sue upon contracts entered into by him.
3. When family disputes are settled by mutual agreement and

the terms of settlement are written down in a document, it is called a Family Settlement. Such agreements can be enforced by members of the family who were not originally parties to the settlement.

With the exception of the above three cases, a contract cannot confer rights upon a person who is not a party to it. Also, a contract cannot impose a liability upon a person who is not a party to it.

Examples :

- (i) A and B entered into an agreement to pay a certain sum of money to their children C and D upon their marriage. The marriage took place. A died. C sued to recover the money from the executors of A. Held, he cannot sue. *Tweddle v. Atkinson*.¹
- (ii) P sold to Q some rubber with a condition that the goods were not to be resold below a certain price. Q sold the goods to R who was aware of the condition. R resold the goods below the stated price. Held, P cannot enforce the condition against R because there was no contract between P and R. *McGruther v. Pitcher*.²

EXERCISES

1. Define consideration. Is there any difference between English and Indian law in respect of consideration? (C.U. '59).
2. X promises a subscription of Rs. 10 000 to the Gandhi memorial fund. He does not pay. Is there any remedy in a court of law against him? (C.U. '49).
3. Explain the term 'consideration' and state the exceptions to the rule, "No consideration, no contract." (C.U. '50; '55).
4. Discuss the rule that a stranger to a contract cannot sue on the contract and the exceptions to that rule. (C.A., May '54).
5. What agreements are contracts even though made without consideration? Does an agreement become void merely because consideration is inadequate? Give reasons. (C.U. '57).
6. Examine if there can be enforceable agreements without consideration. (C.A., Nov. '58).

¹ (1861) 1 B & S 393.

² (1904) 2 Ch. 306.

CHAPTER 5

VOID AND VOIDABLE AGREEMENTS

An agreement which does not satisfy the essential elements of a contract may be either void or voidable. The definitions of these terms are given below.

1. Void Agreement. “An agreement not enforceable by law is said to be void.”—Sec. 2(g). A void agreement has no legal effect. It confers no rights on any person and creates no obligations.

Examples of Void Agreement : an agreement made by a minor; agreements without consideration (except the cases coming under Sec. 25); certain agreements against public policy; etc. [See under Ch. 8.]

Agreements which become void : An agreement, which was legal and enforceable when it was entered into, may subsequently become void due to impossibility of performance, change of law or other reasons. When it becomes void the agreement ceases to have legal effect. [The rights and obligations of the parties in such cases are discussed in Ch. 13.]

2. Voidable Agreement. A voidable agreement is one which can be avoided, i.e., set aside by some of the parties to it. Until it is avoided, it is a good contract. “An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.”—Sec. 2(i).

Examples of voidable contracts contracts brought about by coercion, undue influence, misrepresentation etc.

X coerces Y into entering into a contract for the sale of Y's house to X. This contract can be avoided by Y. X cannot enforce the contract. But Y, if he so desires, can enforce it against X.

Unenforceable Agreement. The term Unenforceable Agreement is used in English law. It means an agreement which cannot be enforced by a court of law because of some technical defects, e.g., want of registration or non-payment of the requisite stamp duty.

Illegal Agreement. An Illegal Agreement is one which is against a law in force in India. *Example :* an agreement to commit murder or robbery.

Distinction between a Void Agreement and an Illegal Agreement:
 An illegal agreement is also void. But a void agreement is not necessarily illegal. An agreement may not be contrary to law but may still be void. An agreement the terms of which are uncertain is void, but such a contract is not illegal.

When an agreement is illegal, other agreements which are incidental or collateral to it are void. The reason underlying this rule is that the courts will not enforce any agreement entered into with the object of assisting or promoting an illegal transaction.

If the main agreement is void, (but not illegal) agreements which are incidental or collateral to it may be valid.

Examples :

- (i) A engages B to kill C and borrows Rs. 100 from D to pay C. Here the agreement with B is illegal. The agreement with D is collateral to it, if D is aware of the purpose of the loan. In this case the loan transaction is void and D cannot recover the money. But if D is not aware of the purpose of the loan, it may be argued that the loan transaction is not collateral to the other illegal agreement and is valid.
- (ii) A enters into a wagering agreement, and borrows Rs. 100 for the purpose. The main agreement is void but the loan transaction being merely collateral to it is valid even though the creditor is aware of the purpose of the loan.

EXERCISES

~~1.~~ Distinguish between void agreements and voidable contracts. What agreements are void according to the Indian Contract Act? (C.U. '60).

2. Write notes on Unenforceable Agreement, Illegal Agreement.

3. Explain the difference between a void and illegal transaction with reference to collateral transactions. Give one illustration for each. (C.A. Nov. '59).

CHAPTER 6

CAPACITY OF PARTIES

One of the essential conditions for the validity of an agreement is that *all* the parties to it must have capacity to enter into contracts. Section 11 of the Contract Act states that, "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."

From Section 11 it follows that a person is incapable of entering into contracts under the following circumstances :

- (i) if he has not attained the age of majority according to the law to which he is subject ;
- (ii) if he is not of sound mind (*i.e.* if he is a lunatic or an idiot or suffering from a similar disability) ; and,
- (iii) if he is disqualified from contracting by any law to which he is subject.

Cases of Incapacity are discussed below.

MINORITY

Who is a minor ? According to the Indian Majority Act, 1875, a minor is one who has not completed his or her 18th year of age. So a person becomes a major after the completion of 18 years of life. To this rule there are two exceptions—(i) when a guardian of the minor's person or property is appointed by a court of law and (ii) when a minor's property is taken over by the Court of Wards¹ for management. In either of these two cases minority continues up to the completion of the 21st year. In England minority continues up to the completion of the 21st year in all cases.

The Law regarding Minor's Agreements. The law regarding agreements by minors may be summarised as follows :

1. An agreement by a minor is (subject to the exceptions noted under 2 and 3 below) absolutely void and inoperative. *Mohori Bibi v. Dharmodas Ghose*.² In this case a minor executed a mortgage for

¹ Under the Court of Wards Act, estates of incompetent persons like minors or lunatics can be placed under the guardianship of the Court of Wards. The Board of Revenue usually acts as the Court of Wards.

² (1903) 30 I. A. 114.

Rs. 20,000 and received Rs. 8,000 from the mortgagee. He sued for setting aside the mortgage. The mortgagee wanted refund of the sum which he had actually paid, viz. Rs. 8,000. The Privy Council held that an agreement by a minor was absolutely void and therefore the question of refunding the money did not arise. [Had the agreement been only voidable, the benefit received would have been refundable under Sec. 64 or Sec. 65 of the Act. *See post* under Ch. 12.)

The decision of the Privy Council that, an agreement by a minor is void, is based upon a strict interpretation of Section 11 of the Act. The reason underlying the rule is that a minor is supposed to be incapable of judging what is good for him. His mental faculties are not mature and therefore the law protects him. With certain exceptions, promises made by a minor will not be enforced against him.

2. A minor can be a promisee. An agreement under which a minor has received a benefit can be enforced as against the other party. A minor in whose favour a mortgage has been executed can get a decree for the enforcement of the mortgage. *Raghavachariar v. Srinivas*.³ Similarly a promissory note executed in favour of the minor can be enforced. Under English law, agreements for the infant's education, service, or apprenticeship, and agreements which enable him to earn his living are binding unless they are detrimental to his interests.

Example :

D, an infant professional boxer, held a licence from the British Boxing Board under which his money was to be stopped if he was disqualified. In a match he was disqualified and the Board withheld his money. D sued to recover it. Held, the contract was for his benefit and was binding on him. *Doyle v. White City Stadium*.⁴

3. The minor's property is liable for the payment of a reasonable price for necessaries supplied to the minor or to anyone whom the minor is bound to support.

What is a necessary article is to be determined from the status, and the social position of the minor. The price which the trader will get is reasonable price, not the price "agreed to" by the minor. Only the minor's property is liable. The minor is not personally liable.

Examples :

- (i) A trader supplies a minor with rice needed for his consumption. He can recover the price from the minor's property.

³ 40 Mad 308.

⁴ (1935) 1 K.B. 110.

- (ii) Inman, an infant undergraduate in Cambridge, bought eleven fancy waistcoats from Nash. He was at the time adequately provided, with clothing. Held, the waistcoats were not necessary and the price could not be recovered. Nash v. Inman.^o
- (iii) When a minor is engaged in trade, contracts entered into by him for trading purposes are not for necessities and are not binding on him.
- (iv) It has been held that reasonable expenses incurred for the following purposes are necessities—marriage of the minor; marriage of his sister; cost of defending a minor in civil and criminal proceedings; funeral ceremonies of the wife, husband or children of the minor; sradh ceremonies of the ancestors of the minor.

The case of necessities supplied to a minor is covered by Section 68 of the Contract Act which provides as follows : "If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessities suited to his condition of life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person." So far as necessities are concerned, the minor's liability arises not out of contract but *quasi ex contractu*. Fletcher Moulton J, in *Nash v. Inman* observed as follows : "The basis of the action is hardly contract. Its real foundation is an obligation which the law imposes on the infant to make a fair payment in respect of needs satisfied. In other words, the obligation arises *re* and not *consensu*."

4 A minor cannot be compelled to compensate for or refund any benefit which he has received under a void agreement because Sections 64 and 65 of the Act do not apply to such cases. But it has been held in a number of cases that the court may, on adjudging the cancellation of an instrument at the instance of a minor, require the minor to make compensation to the other party to the instrument. The court's power, to do so, is given by Section 41 of the Specific Relief Act (Act I of 1877) which is as follows : "On adjudging the cancellation of an instrument the court may require the party to whom such relief is granted to make any compensation to the other which justice may require." Section 38 of the Specific Relief Act provides in similar terms for cases where a contract is rescinded.

Example :

A minor sells a house for Rs. 10,000. Later he files a suit to set aside the sale on the ground of minority. He may be directed to refund the purchase-money received by him.

5. A minor who falsely represents himself to be a major, and thereby induces another person to enter into an agreement with him,

^o (1908) 2 K.B. 1.

can nevertheless plead minority as a defence in an action on the agreement. There can be no estoppel against a minor. *Sadik Ali Khan v. Jaikishore*.⁶ In the English case, *R. Leslie Ltd. v. Sheill*,⁷ the Court of Appeal held that where an infant obtains a loan by falsely representing his age, he cannot be made to pay the amount of the loan as damages for fraud, nor can he be compelled in equity to repay the money. But in India it has been held that the court can direct the minor to pay compensation to the other party in such cases. *Khan Gul v. Lakha Singh*.⁸

[*The Principle of Estoppel* : The Principle of estoppel is a rule of evidence. When a man has, by words spoken or written, or by conduct, induced another to believe that a certain state of things exists, he will not be allowed to deny the existence of that state of things. "Estoppel arises when you are precluded from denying the truth of anything which you have represented as a fact, although it is not a fact." (Lord Halsbury)].

6. A minor on attaining majority cannot ratify an agreement entered into while he was a minor. The reason is that a void agreement cannot be validated by any subsequent action and a minor's agreement is void *ab initio*. *Mahendra v. Kailash*.⁹

7. An agreement by a minor being void, the court will never direct specific performance of such an agreement by him.

8. A minor cannot enter into a contract of partnership. But he can be admitted into the benefits of a partnership with the consent of all the partners. (See under Partnership).

9. A minor can be an agent. A minor can draw, make, indorse, and deliver negotiable instruments so as to bind all parties except himself. A minor cannot be adjudicated an insolvent. Where a minor and a major jointly enter into an agreement with another person, the minor has no liability but the contract can be enforced against the major if his liability can be separately ascertained. If an adult stands surety for a minor the adult is liable on the agreement although the minor is not.

10. An agreement entered into by the guardian of a minor on his behalf stands on a different footing from an agreement entered into by the minor himself. An agreement by a minor is void but an agreement by his guardian on his behalf is valid provided the obligations undertaken are within the powers of the guardian. General

⁶ *R. (1928) P. C. 152.*

⁷ (1914) 3 K. B. 607.

⁸ (1928) 9 Lah. 701.

⁹ 55 Cal 841

speaking an agreement made by the guardian is binding on the minor if it is for the benefit of the minor or is for legal necessity. The powers of a guardian are determined by the personal law of the minor and by the Guardian and Wards Act.

The English law regarding agreements by infants. Under English law, infancy lasts up to the midnight of the date preceding the 21st birthday of a person. The English law relating to agreements by infants is based on the Common Law as modified by the Infants' Relief Act of 1874. The present position can be summed up as follows :

1. Contracts for the supply of necessities to an infant (or his wife) and contracts for the infant's benefit (*e.g.*, apprenticeship contracts) are valid and binding.
2. Infants holding beneficial interests in property (*e.g.* leases, shares in companies, etc.) are bound by the obligations connected with such interests. They may, however, repudiate the interest and all liabilities connected therewith during minority or within a reasonable time after attaining majority.
3. Three types of contracts have been expressly declared to be void, *viz.*, (i) contracts for the repayment of money lent or to be lent; (ii) contracts on accounts stated; and (iii) contracts for the sale of goods, other than necessities.
4. All other types of contracts are unenforceable against infants.

PERSONS OF UNSOUND MIND

For an agreement to be valid as a contract it is necessary that each party to it should have a sound mind. What is a "sound mind" for the purpose of contracting, is laid down in Section 12 of the Indian Contract Act.

Section 12 : "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests.

✓ A person who is usually of unsound mind, but occasionally of sound mind may make a contract when he is of sound mind.

✓ A person who is usually of sound mind, but occasionally of unsound mind may make a contract when he is of sound mind.

✓ A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind."

Illustrations :

(a) A patient in a lunatic asylum, who is at intervals of sound mind, may make a contract during these intervals.

(b) A sane man who is delirious from fever, or who is so drunk

that he cannot understand the terms of a contract, or form a rational judgment as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts."

The test of soundness of mind is (i) capacity to understand the business concerned and (ii) ability to form a rational judgment as to its effect on a person's interest.

Unsoundness of mind may arise from—insanity or lunacy; idiocy; drunkenness and similar factors. A person under the influence of hypnotism is temporarily of unsound mind. Mental decay brought about by old age or disease also comes within the definition.

In each case it is a question of fact to be decided by the court whether the party to the contract was of sound mind or not. There being a presumption in favour of sanity, the person who relies on unsoundness of mind must prove it sufficiently to satisfy the court.

Idiocy. The term idiot is applied to a person whose mental powers are completely absent. Idiocy is a congenital defect caused by lack of development of the brain.

Lunacy or Insanity. This is a disease of the brain. A lunatic is one whose mental powers are deranged so that he cannot form a rational judgment on any subject. Lunacy can sometimes be cured. Idiocy is incurable.

Drunkenness. Drunkenness produces temporary incapacity. The mental faculties are clouded for a time, so that no rational judgment can be formed.

✱ **Effects of Agreements made by Persons of Unsound Mind.** Agreements by persons of unsound mind are void. But an agreement entered into by a lunatic or a person of unsound mind for the supply of necessities for himself or for persons whom he is bound to support (e.g., his wife or children) is valid as a quasi-contract under Section 68 of the Act. Only the estate of such a person is liable. There is no personal liability.

✓ If an agreement entered into by a person of unsound mind is for his benefit, it can be enforced. *Jugal Kishore v. Cheddu*.¹

The guardian of a lunatic can bind the estate of the lunatic by contracts entered into on his behalf. The mode of appointment of such a guardian and his powers are laid down in the Lunacy Act.

¹ (1903) All L. J. 43

ALIENS

An alien means a citizen of a foreign state. Contracts with aliens are valid. An alien living in India is free to enter into contracts with citizens of India. But the state may impose restrictions. Certain types of transactions with aliens may be prohibited. In Great Britain formerly, aliens were not permitted to purchase shares in British ships. A contract with an alien becomes unenforceable if war breaks out with the country of which the alien concerned is a citizen.

FOREIGN SOVEREIGNS

Foreign sovereigns or governments cannot be sued unless they voluntarily submit to the jurisdiction of the local court. *Mighell v. Sultan of Johore*.²

Foreign sovereigns and governments can enter into contracts through agents residing in India. In such cases the agent becomes personally responsible for the performance of the contracts. [See *post* under Agency].

The rules regarding suits by or against foreign sovereigns and governments are laid down in Section 84-87 of the Civil Procedure Code.

CORPORATIONS

A Corporation is an artificial person created by law. *Examples*—companies registered under the Companies Act; public bodies created by statute like the Corporation of Calcutta or the Reserve Bank of India.

A corporation is an artificial person capable of suing and of being sued. But the contractual powers of a corporation are limited in two ways : (i) natural possibility and (ii) legal possibility.

(i) *Natural Possibility*—The fact that a corporation is an artificial person leads to the result that a corporation must always enter into contracts through agents. Also, a corporation cannot enter into contracts of a strictly personal nature. In the case of *West of England and South Wales District Bank*,³ it was held that a corporation cannot act as the treasurer of a friendly society for that involves activities of a personal nature. In India, under the Companies Act, 1956, a corporation can act as Secretaries and Treasurers.

(ii) *Legal Possibility*—A joint stock company cannot enter into

² (1894) 1 Q.B. 149

³ (1879) 11 Ch D. 768

any contract the objects of which go beyond the memorandum of association of the company. A statutory corporation cannot enter into any contract which is beyond the scope of its powers as laid down in the statute by which it was created.

Examples :

- (i) The London County Council had statutory powers to purchase and work tramways. Held, they could not work omnibuses. *London County Council v. Attorney General*.⁴
- (ii) A company had powers under its memorandum of association to make and sell railway carriages. It bought a railway concession in Belgium. Held, the purchase was *ultra vires* and void. *Ashbury Railway Carriage Company v. Riche*.⁵

PROFESSIONAL INCAPACITY

In England barristers are prohibited by the etiquette of their profession from suing for their fees. • So also are members of the Royal College of Physicians. But they can sue and be sued for all claims other than their professional fees. For example, if a barrister, or a member of the Royal College of Physicians engages a contractor for building a house, he can sue for the enforcement of the contract.

In India these personal disqualifications do not exist. It has been held in *Nihal Chand v. Dilwar Khan*,⁶ that a barrister can sue for his fees in India. A barrister, before he can practice in India, must be enrolled as an advocate under the Bar Council's Act of 1927 and his legal status comes from such enrolment. The Bar Councils Act does not prohibit advocates from suing for their fees.

In India there is no restriction upon doctors as regards suing for their fees.

MARRIED WOMEN

In India there is no difference between men and women as regards contractual capacity. A woman (married or single) can enter into contracts and deal with her properties in any way she likes provided she is a major and does not suffer from any disability like lunacy or idiocy.

Under English law, prior to 1883, the position was different for married women. Upon marriage, the properties of a woman passed to her husband. Her contractual powers, regarding those properties, were lost. The position was altered by a series of statutes, passed

⁴ (1902) A.C. 165

⁵ (1875) L.R. 7 H.L. 653

⁶ 55 All 570 (Full Bench)

from 1883 onwards, known as Married Women's Property Acts. Married women in England now possess the same contractual capacity as men.

In both India and England, a married woman can bind her husband's properties for necessities supplied to her. She is an agent of her husband for this purpose. [See under Agency].

EXERCISES

1. X, a barrister in Calcutta sues Y his client for his professional fees. Will he succeed? Will the answer be the same if X is a surgeon? (C.U. '46).
2. Discuss with suitable illustrations the validity of contracts by infants. (C.A., Nov. '51).
3. What is the effect of agreements entered into by persons of unsound mind?
4. What do you understand by capacity to contract? What is the effect of any agreement made by persons not qualified to contract? (C.U. '61).

CHAPTER 7

FREE CONSENT

An agreement is valid only when it is the result of the “free consent” of all the parties to it. Section 13 of the Act defines the meaning of the term ‘consent’ and Section 14 specifies under what circumstances consent is ‘free’.

Section 13 : “Two or more persons are said to consent when they agree upon the same thing in the same sense.”

Consent involves a union of the wills and an accord in the minds of the parties. When the parties agree upon the same thing in the same sense, they are said to be *ad idem*. For a valid contract the parties must be *ad idem*.

Section 14 : This section lays down that consent is *not free* if it is caused by—coercion, undue influence, fraud, misrepresentation, or mistake. The effects, of coercion etc., on the formation of a contract are explained below.

COERCION

Coercion is defined by Section 15 of the Act as follows : “Coercion is the committing or threatening to commit, any act forbidden by the Indian Penal Code, or unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever with the intention of causing any person to enter into an agreement.

Explanation.—It is immaterial whether the Indian Penal Code is or is not in force in the place where the coercion is employed.”

The provisions of Section 15 can be analysed as follows :

1. Coercion means (i) committing or threatening to commit an act “forbidden” by the Indian Penal Code, or (ii) the unlawful detaining or threatening to detain any property.

2. It does not matter whether the Indian Penal Code is or is not in force in the place where the coercion is employed.

3. The act, constituting coercion, may be directed at *any* person and not necessarily at the other party to the agreement.

4. The act, constituting coercion, must have been done or threatened with the intention of causing any person to enter into an agreement.

Examples :

- (i) A threatens to shoot B if he does not let out his house to A, and B agrees to do so. The agreement has been brought about by coercion.
- (ii) A threatens to shoot B if C does not let out his house to A and C agrees to do so. The agreement has been brought about by coercion.
- (iii) An agent appointed by a person refused to hand over the books of account of the principal unless the principal released him from all liabilities concerning past transaction. The principal gave a release as demanded. Held, the release was obtained by coercion and was not binding. *Muthia v. Karuppan*.¹
- (iv) A girl of 13 was made to agree to adopt a boy by her husband's relatives who prevented the removal of the dead body of her husband until she consented to the adoption. Held, the agreement to adopt was not binding. *Ranganayaka v. Alwar*.²
- (v) A, on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. A afterwards sues B for breach of contract at Calcutta. A has employed coercion although his act is not an offence by the law of England and although the Indian Penal Code was not in force at the time when or the place where the act was done.

Certain Special Cases :

(1) A threat to prosecute a man or to file a suit against him. These acts do not constitute coercion because they are not forbidden by the Indian Penal Code.

2. High prices and high interest rates. It is not coercion to charge high prices or high interest rates because such acts are not forbidden by the Indian Penal Code.

3. **A threat to commit suicide**—Consent to an agreement may be obtained by threatening to commit suicide e.g. by a fast to death. The Madras High Court has held that this amounts to coercion. *Amiraju v. Seshamma*.³ It was, however, argued by one of the judges of the Bench which decided this case that Section 15 must be construed strictly and that an act which is not punishable under the Indian Penal Code cannot be said to be "forbidden" by it. Suicide is not punishable by the Indian Penal Code (only the attempt to commit suicide is punishable). Therefore, it was observed that, suicide is not forbidden by the Indian Penal Code and the threat to commit suicide is not coercion.

¹ 50 Mad 786

² 13 Mad 33

³ 41 Mad 33

Duress—The term duress is used in English law to denote threats over the person of another with a view to obtain the consent of a party to an agreement. The scope of the term coercion is wider because it includes threats over property.

/// **Consequences of Coercion**—A contract brought about by coercion is voidable at the option of the party whose consent was so caused.—Sec. 19. The aggrieved party can have the contract set aside or he can refuse to perform it and take the defence of coercion if the other party sought to enforce it. The aggrieved party may, if he so desires, abide by the contract and insist on its performance by the other party.

UNDUE INFLUENCE

A contract is said to be induced by undue influence where (i) one of the parties is in a position *to dominate the will of the other* and (ii) he uses the position to obtain *an unfair advantage* over the other—Sec. 16(1).

Section 16(2) provides that undue influence may be presumed to exist in the following cases :

1. Where one party holds a real or apparent authority over the other or where he stands in a fiduciary relationship to the other. Fiduciary relationship means a relationship of mutual trust and confidence. Such a relationship is supposed to exist in the following cases—father and son; guardian and ward; solicitor and client; doctor and patient; preceptor and disciple; trustee and beneficiary etc.

2. Where a party makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

Examples :

- (i) A having advanced money to his son B during his minority, upon B's coming of age obtains by misuse of parental influence, a bond from B for a greater amount than the sum advanced. A employs undue influence.
- /// (ii) A, a man enfeebled by disease or age, is induced by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his professional services. B employs undue influence.
- (iii) A Malay woman of great age and wholly illiterate made a gift of almost the whole of her property to her nephew who was managing her estates. The gift was set aside on the ground of undue influence. *Inche Noriah v. Shaik Omar*.⁴

⁴ (1929) A.C. 127

Consequences of Undue Influence. An agreement induced by undue influence is voidable at the option of the party whose consent was so caused. Such an agreement may be set aside absolutely or, if the party who was entitled to avoid it has received any benefit thereunder, the court can set it aside upon such terms and conditions as may seem just.—Sec. 19A. The aggrieved party may, if he desires, treat the agreement as binding and enforce it against the other party.

Burden of Proof. If a party is proved to be in a position to dominate the will of another and if it appears that the transaction is an unconscionable one, the burden of proving that the contract was not induced by undue influence, lies on the party who was in a position to dominate the will of the other.—Sec. 16(3).

The existence of the power to dominate the will of another may be presumed to exist under the circumstances mentioned in Section 16(2). [See *ante*].

It has been held by judicial decisions that the existence of a power to dominate the will of another cannot be presumed in the following cases :

Husband and wife (*Howatson v. Webb*⁵); landlord and tenant; creditor and debtor. In these cases the party alleging undue influence must prove that undue influence existed.

Lack of judgment, want of prudence, lack of knowledge of facts, or absence of foresight are generally not, by themselves, sufficient reasons for setting aside a contract. Undue influence cannot be presumed merely from the existence of any of aforesaid defects in a party. *Allcard v. Skinner*.⁶

According to the Madras High Court undue influence by a person, who is not a party to the contract, may make the contract voidable.

Undue influence is suspected in the following cases :

- (i) Inadequacy of consideration.
- (ii) Fiduciary relationship between the parties.
- (iii) Inequality between the parties as regards age, intelligence, social status etc.
- (iv) Absence of independent advisors for the weaker party.

High rates of interest and high prices. It is usual for money-lenders to charge high rates of interest from needy borrowers. Can the court presume the existence of undue influence in such cases ?

Illustration (d) of Section 16, Contract Act is as follows : “A

⁵ (1907) 1 Ch. 537

⁶ (1887) 36 Ch. D. 145

applies to a banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. *A* accepts the loan on these terms. This is a transaction in the ordinary course of business and the contract is not induced by undue influence."

So, a transaction will not be set aside merely because the rate of interest is high. But if the rate is so high that the court considers it unconscionable, the burden of proving that there was no undue influence lies on the creditor. This is made clear by illustration (c) of Section 16 which is as follows: "*A*, being in debt to *B*, the money-lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on *B* to prove that the contract was not induced by undue influence."

In India, in most of the States, there are Money Lenders Acts which lay down the maximum rates of interest which can be charged. Also, under the Usurious Loans Act of 1918, the court has discretionary power to reduce rates of interest whenever they appear to be unconscionable.

As regards high prices the general opinion is that if a trader puts his prices up during scarcity and a buyer agree to pay such high prices, it is a transaction in the ordinary course of business and is not a case of undue influence.

Pardanashin Woman. Women, who observe the custom of *Pardah*, i.e. seclusion from contact with people outside her own family, are peculiarly susceptible to undue influence. Therefore, Indian courts have held that a contract made by or with a *pardanashin* lady may be set aside by her unless the other party to the contract satisfies the court that the terms of the contract were fully explained to her and that she understood their implications.

Difference between Undue Influence and Coercion. In both undue influence and coercion, one party is under the influence of another. In coercion, the influence arises from committing or threatening to commit an offence punishable under the Indian Penal Code or detaining or threatening to detain property unlawfully. In undue influence, the influence arises from the domination of the will of one person over another. Cases of coercion are mostly cases of the use of physical force while in undue influence there is mental pressure. The distinction is sometimes hard to draw.

MISREPRESENTATION

A Representation is a statement or assertion, made by one party

to the other, before or at the time of the contract, regarding some matter or circumstance relating to it. **Misrepresentation** arises when the representation made is inaccurate but the inaccuracy is not due to any desire to defraud the other party. There is no intention to deceive.

Section 18 of the Contract Act classifies cases of misrepresentation into three groups as follows :

1. "The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true."

Example :

A says to B who intends to purchase A's land, "My land produces 12 maunds of rice per bigha." A believes the statement to be true although he did not have sufficient grounds for the belief. Later on it transpires that the land does not produce 12 maunds of rice. This is misrepresentation.

2. "Any breach of duty which, without an intent to deceive, gains an advantage to the persons committing it, or anyone claiming under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him." Under this heading would fall cases where a party is under a duty to disclose certain facts and does not do so and thereby misleads the other party. In English law such cases are known as cases of "constructive fraud".

3. "Causing however innocently, party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement."

✓ **Consequences of Misrepresentation.** In cases of misrepresentation the aggrieved party can :

- (i) avoid the agreement, or
- (ii) insist that the contract be performed and that he shall be put in the position in which he would have been if the representation made had been true.

But if the party whose consent was caused by misrepresentation had the means of discovering the truth with ordinary diligence, he has no remedy.—Sec. 19.

"Ordinary diligence" means such diligence as a reasonably prudent man would consider necessary, having regard to the nature of the transaction.

Example :

A, by a misrepresentation leads B erroneously to believe that five hundred maunds of indigo are made annually at A's factory.

B examines the accounts of the factory, which show that only four hundred maunds of indigo have been made. After this *B* buys the factory. The contract is not avoided by *A*'s misrepresentation.

* FRAUD

The term fraud includes all acts committed by a person with a view to deceive another person. Section 17 of the Contract Act states that "Fraud" means and includes any of the following acts :

(1) "the suggestion as to a fact, of that which is not true by one who does not believe it to be true;" A false statement intentionally made is fraud.

(2) "the active concealment of a fact by one having knowledge or belief of the fact;" Mere non-disclosure is not fraud where the party is not under any duty to disclose all facts. (See below). But *active* concealment is fraud.

Examples :

(i) *B*, having discovered a vein of ore on the estate of *A*, *adopts means to conceal, and does conceal*, the existence of the ore from *A*. Through *A*'s ignorance *B* is enabled to buy the estate at an undervalue. The contract is voidable at the option of *A*.—(Illustration (d) to Sec. 19).

(ii) *A* sells by auction to *B* a horse which *A* knows to be unsound. *A* says nothing to *B* about the horse's unsoundness. This is not fraud because *A* is under no duty to disclose the fact to *B*. But if between *B* and *A* there is a fiduciary relationship (for example if *B* is *A*'s daughter) there arises the duty to disclose and nondisclosure amounts to fraud.—(Illustrations (a) and (b) to Sec. 17).

(3) "a promise made without any intention of performing it;"

Example—purchase of goods without any intention of paying for them.

(4) "any other act fitted to deceive;" To deceive means "to induce a man to believe that a thing is true which is false".

(5) "any such act or omission as the law specially declares to be fraudulent;" This clause refers to provisions in certain Acts which make it obligatory to disclose relevant facts. Thus, under Section 55 of the Transfer of Property Act, the seller of immovable property is bound to disclose to the buyer all material defects. Failure to do so amounts to fraud.

/// To constitute fraud, the act complained of must be brought within any of the five abovementioned categories.

It is to be noted that mere commendation or praising of one's own goods is not fraud. Traders and manufacturers are inclined to

speak optimistically of their products, e.g. "X products are the best in the market." Such statements do not amount to fraud, unless a clear intention to deceive is proved.

Can Silence be Fraudulent? "Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silences is, in itself equivalent to speech." Explanation to Sec. 17.

From the above, the following rules can be deduced :

1. The general rule is that mere silence is not fraud.

Examples :

- (i) A and B being traders enter upon a contract. A has private information of a change in prices which affect B's willingness to proceed with the contract. A is not bound to inform B.
- (ii) H sold to W some pigs which were to his knowledge, suffering from swine-fever. The pigs were sold "with all faults" and H did not disclose the fever to W. Held, there was no fraud. *Ward v. Hobbs*.¹

2. Silence is fraudulent, "if the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak". The duty to speak, i.e. disclose all facts, exists where there is a fiduciary relationship between the parties (father and son; guardian and ward, etc.). The duty to disclose may also be an obligation imposed by statute. (*Example*—Sec. 55 of the Transfer of Property Act). There is also a duty of making full disclosure in contracts of insurance. Whenever there is a duty to disclose, failure to do so amounts to fraud.

3. Silence is fraudulent where the circumstances are such that, "silence is in itself equivalent to speech".

Example :

B says to A, "If you do not deny it, I shall assume that the horse is sound." A says nothing. Here A's silence is equivalent to speech. If the horse is unsound A's silence is fraudulent.

Conditions and Warranties. The terms embodied in a contract may be divided into two classes—conditions and warranties. A 'condition' is a vital term—a term which goes to the root of the contract. A 'warranty' is a non-essential term—an item which is subsidiary to the main purpose of the contract. Which term is a condi-

¹ (1878) 4 A.C. 13

tion and which term is a warranty, depends upon the intention of the parties which is to be gathered from the facts and circumstances of the case. Statutes sometimes provide for implied conditions and implied warranties *e.g.* the Sale of Goods Act.

A breach of condition entitles the aggrieved party to rescind the contract and also to sue for damages. A breach of warranty only entitles the aggrieved party to sue for damages; he cannot rescind the contract.

Consequences of Fraud. A party who has been induced to enter into an agreement by fraud has the following remedies open to him.—Sec. 19 :

1. He can avoid the performance of the contract.
2. He can insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representations made had been true.

Example :

A fraudulently informs B that A's estate is free from encumbrance. B thereupon buys the estate. The estate is subject to a mortgage. B may avoid the contract or may insist on its being carried out and the mortgage debt redeemed.

3. The aggrieved party can sue for damages. Fraud is a civil wrong or Tort; hence, compensation is payable.

Relief for fraud can be obtained only if the following conditions are satisfied :

1. The act must have been committed by a party to a contract or with his connivance or by his agent.

2. The act must have been done with the intention to deceive and must actually deceive. A deceit which does not deceive gives no ground of action.

3. The consent of the party was obtained by the act complained of. A fraudulent act which did not cause the consent to a contract of the party on whom such fraud was practised, does not make the contract voidable.

4. In cases of fraudulent silence, the contract is not voidable if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

5. The remedy of rescinding the agreement is not available in cases of approbation (*i.e.* acceptance of the agreement) and laches or undue delay in taking action.

DISTINCTION BETWEEN FRAUD AND MISREPRESENTATION

1. In misrepresentation there is no intention to deceive. Fraud implies an intention to deceive.

2. In case of fraud the party aggrieved can rescind the contract (*i.e.* the contract is voidable at his option). He can also sue for damages. In case of misrepresentation the only remedy is rescission. There can be no suit for damages.

3. In case of misrepresentation if the circumstances were such that the aggrieved party might have discovered the truth with ordinary diligence, the contract cannot be avoided. The same is the case where there is fraudulent silence. But in other cases of fraud this is no defence. Even if there were independent sources of discovering the truth which were not availed of, the aggrieved party can rescind the contract and/or file a suit for damages.

CONTRACTS UBERRIMAE FIDEI

Uberrimae fidei contracts are contracts where law imposes upon the parties the duty of making a full disclosure of all material facts. In such contracts, if one of the parties has any information concerning the subject matter of the transaction which is likely to affect the willingness of the other party to enter into the transaction, he is bound to disclose the information. The following contracts come within the class of *uberrimae fidei* contracts.

1. Contracts of insurance—The assured must disclose to the insurer all material facts concerning the risk to be undertaken. Upon failure to do so, the contract may be avoided. *London Assurance Co. v. Mansell*.⁸

2. Contracts in which the parties stand in a fiduciary relation to each other, *e.g.*, contracts between solicitor and client, father and son, etc.

3. *Contracts for the Sale of Immovable Property.* Under Section 55 (1) (a) of the Transfer of Property Act, the seller is bound "to disclose to the buyer any material defect in the property or in the seller's title thereto of which the seller is, and the buyer is not, aware, and which the buyer could not with ordinary care discover".

4. *Allotment of shares of companies.* Persons who issue the prospectus of a company have the duty of disclosing all information regarding the company with strict accuracy. [See under Company Law].

5. *Family Settlements.* When family disputes are settled by mutual agreement, each party is bound to disclose any information possessed by him regarding the value of family properties.

MISTAKE

Mistake may be defined as an erroneous belief concerning something. Consent cannot be said to be 'free' when an agreement is entered into under a mistake. An agreement is valid as a contract only when the parties agree upon the same thing in the same sense. The Indian Contract Act lays down the following rules regarding mistake :

1. Mistake may be of two types : (i) mistake of law and (ii) mistake of fact. Mistake of law may again be of two types : (a) mistake as to a law in force in India and (b) mistake as to a law not in force in India.

Mistake on a point of Indian law does not affect the contract. Mistake on a point of law in force in a foreign country is to be treated as a mistake of fact. *A* and *B* make a contract grounded on the erroneous belief that a particular debt is barred by the Indian law of limitation. This is a valid contract. The reason is that every man is presumed to know the law of his own country and if he does not he must suffer the consequences of such lack of knowledge. But if in the above case, the mistake related to the law of limitation of a foreign country, the agreement could have been avoided—Sec. 21.

2. An agreement induced by a *mistake of fact* is void provided the following conditions are fulfilled.—Sec. 20.

- (i) Both the parties to the agreement are mistaken.
- (ii) The mistake is as to a fact essential to the agreement.

Examples :

- (i) *A* agrees to sell to *B* a specific cargo supposed to be on its way from England to Bombay. It turns out that before the day of the bargain the ship conveying the cargo has been cast away and the goods lost. Neither party was aware of the fact. The agreement is void.
- (ii) *A* agrees to buy from *B* a certain horse. It turns out that the horse was dead at the time of the bargain though neither party was aware of the fact. The agreement is void.
- (iii) *A*, being entitled to an estate for the life of *B*, agrees to sell it to *C*. *B* was dead at the time of the agreement, but, both parties were ignorant of the fact. The agreement is void.

3. "An erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not to be deemed a mistake as to a matter of fact."—Explanation to Sec. 20.

Example :

X buys an article thinking that it is worth Rs. 100 while it is actually worth Rs. 50. The agreement cannot be avoided on the ground of mistake.

4. Section 22 of the Act provides that, "A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact". A mistake by one of the parties (Unilateral Mistake) does not generally affect the validity of a contract. But if the mistake is of such a nature as to preclude the existence of consent, the agreement is void, even though the mistake is unilateral. [See below.]

Example :

H contracted with the N Corporation to build a number of houses. In calculating the cost of the houses H by mistake deducted a particular sum twice over and submitted his estimates accordingly. The Corporation agreed to the figures which were naturally lower than actual cost. Held, the agreement was binding as it stood when the Corporation affixed its seal to it, even though it was based upon erroneous estimates. *Higgins Ltd. v. Northampton Corporation*.⁹

Mistake and Consent. Section 10 of the Act provides that an agreement is valid if it is the result of the free consent of the parties. Section 13 of the Act lays down that two or more persons are said to consent when they agree upon the same thing in the same sense. A mistake may prevent the formation of a real agreement "upon the same thing". When one or more of the parties to an agreement suffer from a fundamental error and the consent (apparently given) is not really there, the agreement is void.

A fundamental error, which precludes consent, is sometimes the result of fraud. But fraud is not the necessary or decisive element. An error may arise without the fault of any of the parties to the agreement. Whenever any fundamental error exists, the agreement is void.

Some typical cases of mistake invalidating an agreement are given below.

(a) *Mistakes as to identity of the person contracted with*, where such identity is essential to the contract.

Examples :

- (i) Blenkarn, by imitating the signature of a reputable firm called Blenkiron & Co., induced another firm Y to supply goods to him on credit. The goods were then sold to X. Held, there was no contract between Blenkarn and Y because Y never

(1927) 1 Ch. D. 128

intended to supply Blenkarn. Therefore X obtained no title to the goods. Because the goods were given on credit the question of identity was essential to the agreement. *Cundy v. Lindsay*.¹

- (ii) The managing director of a theatre gave instructions that no tickets were to be sold to S. S, knowing this, asked a friend to buy a ticket for him. With this ticket S went to the theatre but was refused admission. He filed a suit for damages for breach of contract. Held, there was no contract because the theatre company never intended to contract with S. *Said v. Butt*.²

The question of identity must be an essential element in the contract. Where the identity of the party contracted with is immaterial, mistakes as to identity will not avoid a contract. Thus if X goes to a shop, introduces himself as Y and purchases some goods for cash, the contract is valid unless it can be shown that the shopkeeper would not have sold the goods to X had he known that he was not Y.

(b) *Mutual mistake as to the existence of a thing.* All the examples given in the Contract Act under Section 20 come within this category. They have been reproduced above (under "Mistake" para 2).

(c) *Mutual mistake about the identity of a thing.*

Examples :

- (i) X agreed to buy from Y 125 bales of Surat cotton "to arrive ex *Peerless* from Bombay." There were two ships called "*Peerless*" sailing from Bombay, one arriving in October and the other arriving in November. X meant the earlier one and Y the later. Held, there was no contract. *Raffles v. Wichelhaus*.³ In this case there was no *consensus ad idem*; the parties did not understand the same thing in the same sense.
- (ii) X inspected 50 rifles in a shop. Later he telegraphed, "send three rifles." The telegraph clerk by mistake transcribed the message as, "send the rifles" The shopkeeper sent 50 rifles and upon X's refusal to accept, filed a suit for damages. Held, there was no contract. Here the *consensus ad idem* did not arise because of the mistake of a third party. *Henkel v. Pape*.⁴

(d) *Mutual mistake as to the subject-matter of the contract, or the nature of the transaction.* If the contract actually made is substantially different from the contract the parties intended to make, the contract can be avoided.

¹ (1878) L.R. 3 App. cases 459

² (1920) 3 K.B. 497

³ (1864) 2 H. & C. 905

⁴ (1870) L.R. 6 Ex. 7

Examples :

- (i) *M* an old man of feeble sight, endorsed a bill of exchange thinking it was a guarantee. There was no negligence on his part. Held, there was no contract. *Foster v. Mackinnon*.⁸
- (ii) *A* and *B* believing themselves married made a separation agreement under which the husband agreed to pay a weekly allowance to the wife. Later on it transpired that they were not married. In an action by the "wife" for arrears of allowance, it was held that the agreement was void because there was a mutual mistake on a point of fact which was material to the existence of the agreement. *Galloway v. Galloway*.⁹

Rectification of Mistakes. The court cannot rectify a contract but only the written expression of it. When there is a concluded contract but the terms are incorrectly written down, the court can rectify the document. Clerical errors come within this category. The parties can by a fresh agreement always rectify any previous agreement.

EXERCISES

1. State when a consent is not said to be free. What is the effect of such consent on the formation of a contract? (C.U. B.Com. '62).
2. Write notes on : coercion; undue influence; contracts *uberrimae fidei*.
3. What are the essential elements in a fraud which avoids contracts? How does fraud differ from misrepresentation? (C.U. '48).
4. "Mere silence as to facts is not fraud." Explain with illustrations. (C.U. '50).
5. What are the remedies available to an aggrieved person in cases of fraud or misrepresentation? (C.A., Nov. '53).
6. To what extent does mistake affect contracts? (C.U. '46).
7. Discuss the effect of mistake on contracts. (C.A., Nov. '51; May

⁸ (1869) L.R. 4 C.P. 704

⁹ (1914) T.L.R. 531

CHAPTER 8

LEGALITY OF THE OBJECT AND CONSIDERATION

UNLAWFUL CONSIDERATION AND OBJECT

An agreement will not be enforced by the court if its object or the consideration is unlawful. By the expression, "object of an agreement" is meant its 'purpose' or 'design'. The object and the consideration must both be lawful, otherwise the agreement is void.

According to Section 23 of the Act the consideration and the object of an agreement are unlawful in the following cases :

1. *If it is forbidden by law.* An act or an undertaking is forbidden by law when it is punishable by the criminal law of the country or when it is prohibited by special legislation or regulations made by a competent authority under powers derived from the legislature.¹ If the object of an agreement or the consideration is the doing of an act forbidden by law, the agreement is void.

2. *If it is of such a nature that, if permitted, it would defeat the provisions of any law.* If the object or the consideration of an agreement is of such a nature that it would indirectly lend to a violation of the law, the agreement is void.

Examples :

- (i) A's estate is sold for arrears of revenue under the provisions of an act of the legislature, by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law.
- (ii) An agreement by the debtor not to raise the plea of limitation, should a suit have to be filed, is void as tending to limit the provisions of the Limitation Act.
- (iii) A let a flat to R at a rent of £1200 a year. To reduce the Municipal tax he entered into two agreements with R. One, by which the rent was stated to be £450 pounds only and the other, by which R agreed to pay £750 pounds for services in connection with the flat. In a suit filed against R to recover £750, it was held that the agreement was made to defraud the municipal authority and was void and A cannot recover the money. *Alexander v. Rayson*.²

¹ Pollock and Mulla, *Indian Contract Act*, p. 138

² (1936) 1 K. B. 169

3. *If it is fraudulent.* An agreement whose object is to defraud others is void.

Examples :

- (i) A, B, and C enter into an agreement for the division among them of gains acquired or to be acquired by them by fraud. The agreement is void.
- (ii) A, being agent for a landed proprietor, agrees for money, without the knowledge of his principal, to obtain for B a lease of land belonging to his principal. The agreement between A and B is void, as it implies a fraud by concealment by A on his principal.

4. *If it involves or implies injury to the person or property of another.* If the object of an agreement is to injure the person or property of another, it is void.

Examples :

- (i) ~~An agreement by the proprietors of a newspaper to indemnify the printers against claims arising from libels printed in the newspaper, is void. *W. H. Smith & Sons v. Clinton.*³~~
- (ii) ~~An agreement by which a debtor promised to do manual labour for the creditor so long as the debt was not repaid in full has been held to be void under this clause. *Ram Sarup v. Bansil.*⁴~~

5. *If the court regards it as immoral.* An agreement whose object is immoral, or where the consideration is immoral, is void.

Examples :

- (i) A who is B's Mukhtear promises to exercise his influence with B in favour of C and C promises to pay Rs. 1000 to A. The agreement is void because it is immoral.
- (ii) A agrees to let her daughter to hire to B for concubinage. The agreement is void.
- (iii) A let a cab on hire to B a prostitute, knowing that it would be used for immoral purposes. The agreement is void and he cannot recover the hire. *Pearce v. Brooks.*⁵
- (iv) A man who knowingly lets out his house for prostitution cannot recover the rent.

6. *If the court regards it as opposed to public policy.* An agreement which is injurious to the public or is against the interests of the society is said to be opposed to public policy. Public policy is not capable of exact definition and therefore courts do not usually go beyond the decided cases on the subject. They are generally disinclined to create a new head of public policy. *Gherulal Parakh v. Mahadeodas Maiya & ors.*⁶ The following agreements have been held

³ (1908) 26 T. L. R. 34

⁴ 42 Cal 742

⁵ (1866) L. R. 1 Ex. 213

⁶ 1959 (II) S. C. A. 342

to be against public policy : trading with the enemy; traffic in public offices; interference with the course of justice etc. These agreements are discussed below.

AGREEMENT AGAINST PUBLIC POLICY

Trading with the enemy. It is a well settled principle of law that an agreement between citizens of two countries at war with each other is void and inoperative. In India such agreements are allowed where specially permitted by the government.

2. Agreements interfering with the course of justice. Agreements for stifling prosecutions are bad. When an offence has been committed, the guilty party must be prosecuted and any agreement which seeks to prevent the prosecution of such a person is opposed to public policy and is void. But under the Indian criminal law there are certain cases which can be compromised or compounded. These are mostly minor offences like simple hurt. An agreement for the compromise of such a case is valid. In civil cases compromises and settlements are not only allowed but also are encouraged. An agreement to refer present or future disputes to arbitration is a valid agreement. But an agreement varying the statutory period of limitation is not valid.

✱ Champerty and Maintenance.—When a person agrees to help another by money or otherwise in litigation in which he is not himself interested, it is called **Maintenance**. When a person helps another in litigation in exchange of a promise to hand over a portion of the fruits of the litigation, if any, it is called **Champerty**.

Example :

A files a suit against B for the recovery of a house. X promises to advance Rs. 1000 to A for the costs of the litigation and A promises to give to X a portion of the house if he is successful in his suit. This is a champertous agreement.

According to English law an agreement which amounts to Champerty is void because it is against public policy to promote litigation. But an agreement which amounts to Maintenance only, is good if it can be shown that the motive underlying the help given is purely charitable. It has been held by the Privy Council in the case of *Ramcoomar v. Chandrakanta*,⁷ that the English doctrines of champerty and maintenance are not applicable to India. In India, an agreement to finance litigation in return of a portion of the results of the litigation is valid provided the litigation was instituted with a bona fide motive. If, however, the litigation was inspired by a malicious motive or is of a gambling character, the agreement is bad.

3. Traffic in public offices. Agreements tending to injure the public services are void as being against public policy.

Examples :

- (i) An agreement the object of which is to procure a public post is void.
- (ii) An agreement to share the emoluments of a public office is void.
- (iii) An agreement to sell a religious office *e.g.* that of a shebait or a mutawali is void.
- (iv) The secretary of a certain college promised Col. Parkinson that if he made a large donation to the college, he would use his influence to secure a knighthood for him. Col. Parkinson made a large donation but did not get a knighthood and sued for the recovery of the money. Held, the action failed because the agreement was against public policy. *Parkinson v. College of Ambulance Ltd.*^{*}
- (v) A promises to obtain for B an employment in the public service and B promises to pay Rs. 1000 to A. The agreement is void.

4. Agreements creating an interest opposed to duty. It has been held in several cases that if a person enters into an agreement whereunder he will have to follow a course of action which is against his public or professional duty, the agreement is against public policy and is bad.

Examples :

An agreement by an agent whereby he would be enabled to make secret profits; an agreement for the purchase of property by a public officer where such purchase is prohibited by law; an agreement by a newspaper proprietor not to comment on the conduct of a particular person. *Neville v. Dominion of Canada News Co.*⁹

5. Agreements restraining personal freedom. Agreements unduly restraining personal liberty have been held to be void as being against public policy.

Examples :

- (i) An agreement by a debtor to do manual work for the creditor so long as the debt was not paid in full.
- (ii) An agreement whereof the debtor promised to a moneylender that he will not change his residence or his employment or agree to a reduction of his salary without the consent of the moneylender was held to be void. *Horwood v. Millar's Timber Co.*¹

^{*} (1925) 2 K. B. I.

⁹ (1915) 3 K. B. 556

¹ (1917) 1 K. B. 305

6. Agreements interfering with parental duties. The authority of a father over children and of a guardian over his ward is to be exercised in the interest of the children and the wards respectively. The authority of a father cannot be alienated irrevocably and any agreement purporting to do so is void. An agreement to receive money for giving a daughter in marriage has been held to be void in a case.

7. Agreements interfering with marital duties. Agreements which interfere with the performance of marital duties are void as being against public policy.

Examples :

- (i) An agreement to lend money to a woman in consideration of her getting a divorce and marrying the lender is void. *Roshan v. Mahomad.*²
- (ii) An agreement that the husband will always stay at the mother-in-law's house and that the wife would never leave her parental house is void. *Tikayat v. Monohar.*³

8. Marriage brokerage or marriage brocage agreements. According to English law an agreement to pay brokerage to a person for negotiating a marriage, is void because it is against public policy. The principle underlying this rule is that marriages should take place according to the free choice of parties and such choice should not be interfered with by third parties acting as brokers. In India, however, marriages are in most cases negotiated by the parents of the parties and the custom of appointing agents or brokers for finding out a suitable match is well-established. Therefore there was some difference of opinion on the question whether the English rule regarding marriage brocage contracts should be applied here. The leading cases on the point were discussed in *Bakshi Das v. Nadu Das*,⁴ and the following rules were deduced :

1. An agreement to remunerate a third person in consideration of negotiating a marriage is contrary to public policy and cannot be enforced.

2. An agreement to pay money to the parents or the guardian of the bride or the bridegroom in consideration of their agreeing to the betrothal is not necessarily immoral or opposed to public policy.

²P. R. 46 of 1887

³28 Cal 751

⁴1 C. L. J. 261

3. Where the parents of the bride are not seeking her welfare but are giving her to a husband otherwise ineligible in consideration of the payment of money, the agreement is void.

4. A suit will lie to recover the value of ornaments or presents given to an intended bride or bridegroom, in the event of the marriage not taking place.

VOID AGREEMENTS

An agreement can be void because of mistake, lack of consideration, want of capacity and many other defects. In addition to these cases, the Indian Contract Act expressly declares certain types of agreement to be void. These are discussed below.

1. **Agreements in restraint of marriage.** According to section 26 of the Contract Act, "Every agreement in restraint of the marriage of any person, other than a minor, is void." Restraint of marriage means any restriction or limitation on a person's right to marry. Under English law a partial restraint on marriage is permissible if it is reasonable. But the Indian law is stricter and no restraint is valid. But a promise to marry a particular person does not imply any restraint of marriage and is therefore a valid contract.) ✓, (✓

2. **Agreements in restraint of trade.** "Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void."—Sec. 27.

"Public policy requires that every man shall be at liberty to work for himself and shall not be at liberty to deprive himself of the fruit of his labour, skill or talent, by any contract that he enters into." *Fraser v. Bombay Ice Company*.⁵

According to English law as laid down in *Nordenfelt v. Maxim Nordenfelt Gun Co.*⁶ contracts which impose unreasonable restraints upon the exercise of a business, trade or profession are void while those which impose reasonable restraints are valid. But in India restraints are not valid except in the few cases provided for statutorily.

Example :

X and Y carried on business as braziers in a certain locality in Calcutta. X promised to stop his business in that locality in consideration of Y paying to him Rs. 900 which he had disbursed as advances to his workmen. X stopped his business but Y failed to pay him the promised money. X filed a suit to recover Rs. 900.

⁵ 29 Bom 107

⁶ (1894) A.C. 535

The court held that the agreement was void under Sec. 27 and nothing could be recovered on the basis of that agreement. *Madhav v. Rajcoomer.*⁷

Cases in which restraint of trade is valid in India. There are certain statutory exceptions to the rule contained in Section 27. An agreement in restraint of trade is valid in the following cases :

(a) "One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any one deriving title to the goodwill from him, carries on a like business therein; provided that such limits appear to the court be reasonable, regard being had to the nature of the business."—Exception 1, Sec. 27.

The seller of the goodwill of a business can be restrained from carrying on a similar business within specified local limits, provided the restraint is reasonable.

Examples :

- (i) A buys from B the goodwill of the business of plying ferry boats across certain ghats on a river and B promises not to ply his boats at those ghats. The restraint is valid.
- (ii) C after selling the goodwill of his business to D promises not to carry on similar business "anywhere in the world". The restraint is void.
- (iii) E a seller of imitation jewellery sells his business to D and promises not to carry on business in "imitation jewellery and real jewellery." Held, the restraint was valid as regards imitation jewellery, not as regards real jewellery. *Goldsoll v. Goldman.*⁸

(b) A partner of a firm may be restrained from carrying on a similar business, so long as he remains a partner.—Sec. 11 (2), Indian Partnership Act.

(c) A partner may agree with his partners that on ceasing to be a partner he will not carry on a similar business within a specified period or within specified local limits.—Sec. 36 (2), Indian Partnership Act.

(d) Partners may, in anticipation of the dissolution of the firm, agree that all or some of them shall not carry on similar business within a specified period or within specified local limits.—Sec. 54, Indian Partnership Act.

Trade Combinations. It has been held in many English cases that an agreement between a group of manufacturers or traders regarding

⁷ (1874) 14 B.L.R. 76

⁸ (1915) 1 Ch. D. 292

the conditions of an industry or the price is binding although it is in restraint of trade, provided the agreement is in the interests of the parties themselves. Thus, pools and cartels whose objects are to promote the welfare of the parties themselves by regulating competition are valid agreements.

Examples :

- (i) Certain ice manufacturers entered into an agreement not to sell ice below a certain minimum price. The agreement was held to be valid. *Franser & Co. v. Bombay Ice Co.*⁹
- (ii) It was agreed among members of a society of hop growers that each member would deliver all hops grown by him to the society, which would market the hops and divide the profits among the members. Held, the agreement was valid. *English Hop Growers v. Derring*.¹

But a trade combination is not valid if it is against the public interest or if it tends to create monopoly. *Attorney General of Australia v. Adelaide S.S. Co.*² It was observed in *Vancouver Brewery Co. v. V. Breweries*³ that, "Liberty of trade is not an asset which the law will permit a person to barter away except in special circumstances."

Negative stipulations in service contracts. A person while in service with another may, by the terms of his service, be prevented from accepting other engagements. For example, a doctor employed in a hospital may be debarred from private practice. Such negative stipulations in service contracts are not considered to be in restraint of trade and are therefore valid.

Sometimes, however, employers seek to restrict former employees from engaging themselves in similar occupations for some period after the termination of their service. In English law such stipulations have been held to be valid if they are for the protection of the employer's interest. Thus in *Fitch v. Dewes*,⁴ the articled clerk of a solicitor stipulated that he would not practice as a solicitor within seven miles of a certain place, after he became qualified as a solicitor and left his previous employment. The agreement was held to be valid. The Indian law regarding restraint of trade is, however, stricter. It has been held in, *Brahmaputra Tea Company v. Scarth*,⁵ that an agreement restraining an employee from taking service or engaging in any similar

⁹ 29 Bom 107

¹ (1928) 2 K. B. 174

² (1914) A. C. 461

³ (1934) P. C. 101

⁴ (1921) 2 A. C. 158

⁵ 11 Cal 545

business for a period of five years from the date of the termination of his service with his previous employers is invalid even though the restriction only extended to a distance of 40 miles from the previous place of work. In *Cohen v. Wilkie*,⁶ an actor was brought out from England under a contract containing a stipulation that he would not play at another theater in India during his tour. The stipulation was held to be void as being in restraint of trade.

3. Agreements in restraint of legal proceedings. Private persons cannot by agreement alter their personal law or the statute law. Section 28 of the Act provides that, "Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent."

The effect of Section 28 can be summed up as follows : An agreement which prohibits a person from taking judicial proceedings, in respect of any right *arising from a contract*, is void. Similarly any limitation of the time within which he may enforce his rights is void. Section 28, is subject to two exceptions :

Exception 1.—An agreement by the parties to a contract to refer *future* disputes to arbitration is valid and binding. An agreement to settle disputes by arbitration prevents the parties from getting the dispute adjudicated by a court of law but nevertheless, such an agreement is binding.

Exception 2.—An agreement in writing to refer a *pending* dispute to arbitration is not rendered illegal by Section 28. The section does not affect the law relating to arbitration.

It is to be noted that Section 28 applies only to rights arising from a contract. It does not apply to cases of civil wrongs or torts.

4. Uncertain Agreements. "Agreements the meaning of which is not certain, or capable of being made certain, are void".—Sec. 29. An agreement cannot be enforced unless the obligations created by it are clearly understood.

Examples :

- (i) A agrees to sell to B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.
- (ii) A, who is a dealer in cocoanut oil only, agrees to sell to B "one hundred tons of oil". The nature of A's trade affords an indication of the meaning of the words and the agreement is valid.

- (iii) A agrees to sell to B "all the grain in my granary at Ram-nagar". There is no uncertainty here to make the agreement void.
- (iv) A agrees to sell to B "one thousand maunds of rice at a price to be fixed by C". As the price is capable of being made certain, there is no uncertainty here to make the agreement void.
- (v) A agrees to sell to B "my white horse for Rs/ 500 or Rs. 1000". There is nothing to show which of the two prices was to be given. The agreement is void for uncertainty.
- (vi) A promises to pay five pounds more after the purchase of a horse if the horse "proved lucky". The promise is too vague to be enforced for it is not possible for the courts to decide when a horse is lucky.

Agreement to agree:

An agreement to enter into an agreement in the future is void for uncertainty unless all the terms of the proposed future agreement are agreed expressly or by implication.

Examples :

- (i) An actress was engaged for a provincial tour. The agreement also provided that if the play was brought to London she would be engaged at a salary "to be mutually agreed upon". Held, there was no contract. *Loftus v. Roberts*.⁷
- (ii) A company agreed with V that on expiration of V's existing contract, they would "favourably consider" the renewal of his contract. Held, no obligation was created to renew the contract. *Montreal Gas Co. v. Vasey*.⁸

5. Agreements by way of wager. (Sec. 30). A wager is an agreement by which money is payable by one person to another on the happening or non-happening of a *future, uncertain* event. "The essence of gaming and wagering is that one party is to win and the other to lose upon a future event, which at the time of the contract is, of an uncertain nature—that is to say, if the event turns out one way A will lose but if it turns out the other way he will win." *Thacker v. Hardy*.⁹

Examples of wagering agreements :

- (i) A agrees with B that if there is rain on a certain day A will pay B Rs. 50. If there is no rain B will pay A Rs. 50.
- (ii) A bet on a horse race is a wagering transaction, although horse racing is permitted by some local law and although there may be official agencies through which bets may be placed and the winnings collected.
- (iii) A share market transaction in which there is no intention to give or take delivery of the shares and where the parties

⁷ (1902) 18 T. L. R. 532

⁸ (1900) A. C. 595

⁹ 4 Q. B. D. 685

intend to deal only with the differences in prices is a wagering transaction.

- (iv) **Lotteries**—A lottery is a game of chance. Therefore, an agreement to buy a ticket for a lottery is a wagering agreement. A lottery may be authorised by the government. The only effect of such authorisation is to exempt the persons conducting the lottery from criminal prosecutions but it remains a wagering transaction. *Dorabji v. Lance*.¹
- (v) **Cross word Puzzles**—In an English case it has been held that a cross-word puzzle, in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution kept with the editor of a newspaper, is a lottery and therefore a wagering transaction. *Coles v. Odham's Press*.²

The following transactions have been held to be not wagers :

(i) Share market transactions in which there is clear intention to give and take delivery of shares.

(ii) Prizes and competitions which are games of skill, e.g. picture puzzles; athletic competitions etc. An agreement to enter into a wrestling contest, in which the winner was to be rewarded by the whole of the sale proceeds of tickets and the party failing to appear on that day would have to forfeit Rs. 500 was held not to be a wagering agreement. *Babasaheb v. Rajaram*.³

(iii) An agreement to contribute to the payment of a prize of the value of Rs. 500 or upwards to the winners of a horse race, is valid. This is a statutory exception laid down in section 30 of the Contract Act.

* (iv) *Contracts of Insurance*. A contract of insurance is not a wagering agreement even though the payment of money by the insurer may depend upon a future uncertain event. Contracts of Insurance differ from wagering agreements in two respects : (a) The holder of an insurance policy must have an insurable interest, i.e. some proprietary or pecuniary interest in the subject-matter of the insurance. Insurance contracts therefore are entered into to protect an interest. In a wagering agreement there is no interest to protect. (b) Contracts of insurance are regarded as beneficial to the public and are therefore encouraged. Wagering agreements do not serve any useful purpose and are therefore considered to be against public policy.

* **The effects of a wagering agreement**. An agreement by way of wager is void. It will not be enforced by the courts of law. Section 30 provides as follows : "Agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on

¹ 42 Bom 676

² (1936) 1 K. B. 416

³ 133 I. C. 254

any wager, or entrusted to any person to abide the result of any game or other uncertain event on which any wager is made.”

In the State of Bombay wagering agreements are, by a local statute, not only void but also illegal.

In the case of void agreements, collateral agreement, *i.e.* agreements which are subsidiary or incidental to the main agreement, are valid. Therefore, though wagering agreements are void, transactions collateral to such agreements are valid. *Gherulal Parakh v. Mahadeodas Maiya & ors.*⁴

Examples :

- (i) Money lent for the purpose of gambling or for paying a gambling debt even if advanced with knowledge of the purpose for which the money is required can be recovered.
- (ii) Where one of several holders of a Derby Sweep ticket sold half of his share to another, the other could enforce his claim in the prize by suit. *Gough v. Lenehan.*⁵

6. Impossible Acts. “An agreement to do an act impossible in itself is void”.—Sec. 56 (Para I.)

Examples :

- (i) A agrees with B to discover treasure by magic. The agreement is void.
- (ii) A contracts to marry B, being already married to C, and forbidden by the law to which he is subject to practice polygamy. The contract is void. But A must make compensation to B for the loss caused to her by the non-performance of the promise.

A contract may become impossible to perform by subsequent events. These cases are discussed below under “termination of contracts.”

OBJECT OR CONSIDERATION UNLAWFUL IN PART

If the consideration or object is partially unlawful, the following rules will apply :

1. If there are several objects but a single consideration the agreement is void if any one of the objects is unlawful.—Sec. 24.
2. If there is a single object but several considerations, the agreement is void if any one of the considerations is unlawful.—Sec. 24.

The two above rules deal with the case where the agreement cannot be divided into two parts—a part which is legal and a part which is illegal.

⁴1959 (II) S.C.A. 342

⁵25 I.C. 355

Example :

A promises to superintend, on behalf of B, a legal manufacture of indigo, and an illegal traffic in other articles. B promises to pay A a salary of Rs. 10,000 a year. The agreement is void. Here a part of the object is legal and a part is illegal but there is a single consideration.

3. Where there is a reciprocal promise to do things legal and also other things illegal, and the legal part can be separated from the illegal part, the legal part is a contract and the illegal part is a void agreement.—Sec. 57.

Example :

A and B agree that A shall sell B a house for Rs. 10,000, but that if B uses it as a gambling house, he shall pay A Rs. 50,000 for it. The first part of the agreement is valid, the second part invalid.

4. In the case of an alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced.—Sec. 58.

Example :

A and B agree that, A shall pay B Rs. 1000 for which B shall afterwards deliver to A, either rice or smuggled opium. This is a valid contract to deliver rice and a void agreement as to opium.

EXERCISES

1. What are agreements by way of wager? What is your opinion about the legal effects of such agreements? Is a contract of insurance a wager? (C.U. '52); '54).

2. Briefly state the Indian law with regard to agreements in restraint of trade. (C.U. '54; C.A., May '50; Nov. '51; May '53).

3. What are the exceptions to the rule that contracts in restraint of trade are void? (C.U. '52).

4. Examine the validity of agreements with consideration and object unlawful in part. (C.A., May '52).

5. Write notes on : marriage brokerage contracts, unlawful consideration; Champerty and Maintenance.

6. Are the following agreements void? Give reasons in each case :

(a) A, agrees to sell to B, 'a hundred tons of oil'.

(b) A, who is a dealer in coconut oil only agrees to sell to B, 'a hundred tons of oil'.

(c) A, agrees to sell to B, 'one thousand maunds of rice at a price to be fixed by C'.

(d) A, agrees to sell to B, 'my white horse for Rs. 500 or Rs. 1000'. (C.U. '58).

CHAPTER 9

REQUIREMENTS AS TO WRITING AND REGISTRATION

An oral contract is a perfectly good contract, except in those cases where writing and/or registration is required by some statute. In India writing is required in cases of lease, gift, sale and mortgage of immovable property; negotiable instruments; memorandum and articles of association of a company; etc. Registration is compulsory in cases of documents coming within the purview of Section 17 of the Registration Act. In England writing is necessary in certain cases enumerated under the Statute of Frauds.

CHAPTER 10

CONTINGENT CONTRACTS

Definition. “A contingent contract is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen.”—Sec. 31.

Example :

A contracts to pay B Rs. 10,000 if B's house is burnt. This is a contingent contract. [Illustration to Sec. 31.]

A contingent contract contains a conditional promise. A promise is “absolute” or “unconditional” when the promisor undertakes to perform it in any event. A promise is “conditional” when performance is due only if an event, collateral to the contract, does or does not happen.

Meaning of Collateral Event · According to Pollock and Mulla¹ a collateral event means an event which is, “neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise.” From this explanation it follows that the following contracts are not contingent contracts :

✓(a) X promises to pay Rs. 100 to any person who recovers some property lost by X.

✓(b) X promises to pay Y Rs. 1000 if he marries Z.

In example (a) there is no contract until and unless somebody finds the lost property. In example (b) there is an offer by X which becomes a binding promise when Y marries Z.

But a contract, whereby A promises to pay B Rs. 10,000 if B's house is burnt, is a contingent contract because the liability of A arises only when B's house is burnt. This is an event collateral to the main contract because the burning of B's house is not the performance required from B under the contract nor is it the consideration obtained from B. It is an independent event.

From the above discussion it follows that there are two essential characteristics of contingent contracts :

¹ Pollock and Mulla, *Indian Contract Act*, p. 235

(a) The performance of such contracts depends on a contingency.

(b) The contingency is uncertain. [If the contingency is bound to happen, the contract is due to be performed in any case and is not therefore a contingent contract.]

Contingency dependent on act of party. A contract may be contingent on some act of a party to the contract or of a third party. But if the performance of a promise is contingent upon the mere will and pleasure of the promisor, there is no contract.²

Examples :

- (i) ✓ A promise to pay, what a third party X shall determine, is valid.
- (ii) The plaintiff entered into a contract for the supply of timber to the Government. One of the terms of the contract was that the timber would be rejected if not approved by the Superintendent of the Gun Carriage Factory for which the timber was required. The timber supplied was rejected. Held, on a suit for breach of contract, that it was not open to the plaintiff to question the Superintendent's decision. *Secretary of State for India v. Arathoon*.³
- (iii) In the case of goods to be manufactured to order, it may be a term of the contract that the goods shall be to the customer's approval. In such a case the customer's judgment, acting *bona fide* and not capriciously, is decisive. *Andrews v. Belfield*.⁴
- (iv) A promise, to pay for a service whatever the promisor himself thinks right or reasonable, is no promise. *Roberts v. Smith*.⁵

Rules regarding Contingent Contracts. Sections 32 to 36 of the Indian Contract Act contain certain rules regarding contingent contracts. They are summarised below.

1. Contracts contingent upon the happening of a future uncertain event, cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.—Sec. 32.

Examples :

- (i) ✓ A makes a contract with B to buy B's horse if A survives C. This contract cannot be enforced by law unless and until C dies in A's lifetime.
- (ii) A makes a contract with B to sell a horse to B at a specified price, if C, to whom the horse has been offered, refuses to buy it. The contract cannot be enforced by law unless and until C refuses to buy the horse.

² See Pollock and Mulla, *op. cit.*, p. 236

³ (1879) 5 Mad. 173

⁴ (1857) 2 C. B. N. S. 779

⁵ (1859) 4 H. & N. 315

- (iii) A contracts to pay B a sum of money when B marries C. C dies without being married to B. The contract becomes void.

2. Contracts contingent upon the non-happening of an uncertain future event, can be enforced when the happening of that event becomes impossible, and not before.—Sec. 33.

Example :

A agree to pay B a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

3. If a contract is contingent upon how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies.—Sec. 34.

Example :

A agrees to pay B a sum of money if B marries C. C marries D. The marriage of B to C must now be considered impossible although it is possible that D may die and that C may afterwards marry B.

✓4. Contracts contingent upon the happening of an event within a fixed time, become void if, at the expiration of the fixed time, such event has not happened, or if, before the time fixed, such event becomes impossible.

Contracts contingent upon the non-happening of an event within a fixed time, may be enforced by law when the time fixed has expired and such event has not happened, or before the time fixed has expired, if it becomes certain that such event will not happen.—Sec. 35.

Examples :

- (i) A promises to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.
- (ii) A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

5. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.—Sec. 36.

Examples :

- (i) A agrees to pay B Rs. 1000, if two straight lines should enclose a space. The agreement is void.
- (ii) A agrees to pay B Rs. 1000 if B will marry A's daughter C. C was dead at the time of the agreement. The agreement is void.

EXERCISES

1. What do you understand by a "contingent contract"? Discuss how far the contingency may be dependent on the act of a party. (C. U. '53).
2. Explain briefly the meaning of contingent contracts. (C. A., Nov. '51).
3. Examine the validity of contracts contingent on impossible events. (C. A., May '52).

CHAPTER 11

PERFORMANCE OF CONTRACTS

A contract creates legal obligations. Each party must perform or offer to perform the promise which he has made. Section 37, para 1, of the Contract Act lays down that, "The parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this act, or of any other law".

The Offer to Perform. The offer to perform the contract is called *Tender*. Offer to perform or Tender may be called attempted performance. A tender, to be legally valid, must fulfil the following conditions.—Sec. 38 :

1. It must be unconditional. A tender coupled with a condition is no tender.

Examples :

- (i) A passenger on a bus offers a rupee note for the fare which is 8 nP only. It is not a valid tender because it imposes a condition on the acceptance of the tender *viz.* the return of the balance out of the rupee. A tender of money must be of the exact sum due. *Bireswar v. the Emperor*.¹
- (ii) A tender of money, must be in legal tender money, not by any foreign money, or by promissory note or cheque. *Jagat v. Nabagopal*.²
- (iii) A tender to pay conditionally upon the other party doing something such as giving a release or accepting the amount in full satisfaction of all demands, is not a valid tender. But of course, a receipt may be demanded after a tender has been accepted.

2. The tender must be made at a proper time and place. What is proper time and place, depends upon the intention of the parties and the provisions of Sections 46-50 of the Act. (See below).

A tender before the due date or at a time and place other than that agreed upon, is not a valid tender. *Eshaqu v. Abdul Bari*.³

3. The person to whom a tender is made must be given a reasonable opportunity of ascertaining that the person by whom it is made is able and willing, there and then, to do *the whole of what he is bound by his promise to do*.

¹ 46 C.W.N. 550

² 34 Cal 305

³ 31 Cal 183

The reason behind this rule is that an offer to perform a part of the promise is not a valid tender.

4. If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.

Example :

A contracts to deliver to B at his warehouse on the 1st March 1873, 100 bales of cotton of a particular quality. A must bring the cotton to B's warehouse, on the appointed day, under such circumstances that B may have a reasonable opportunity of satisfying himself that the thing offered is cotton of the quality contracted for, and that there are 100 bales.

5. When there are several promisees, an offer to any one of them is a valid tender.

Effect of refusal to accept a properly made offer of performance or Tender. Where the promisor has made an offer of performance to the promisee, and the offer has not been accepted, the contract is deemed to be broken by the promisee and he can be sued for breach of contract.

.* BY WHOM IS A CONTRACT TO BE PERFORMED ?

1. In cases involving personal skill, taste, or credit, the promisor must himself perform the contract. The courts will enforce the intention of the parties, as expressed in the contract, or as may be inferred from the circumstances of the case.

2. In all other cases the promisor or his representatives may employ a competent person to perform it.—Sec. 40.

Examples :

- (i) A promises to paint a picture for B. A must perform this promise personally.
- (ii) A promises to pay B a sum of money. A may perform this promise, either by personally paying the money to B or causing it to be paid to B by another.

3. When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor.—Sec. 41.

Death of the Promisor. Contracts* involving personal skill or volition, come to an end when the promisor dies. His heirs or legal representatives are not bound to perform the contract. This rule is

expressed in a latin phrase, *actio personalis moritur cum persona*—a personal cause of action dies with the person concerned.

In cases not involving personal skill or volition, the legal representatives of a deceased promisor are bound to perform the contract. Upon failure to do so, they will be liable for breach of contract. But the liability of the legal representatives is limited to the assets obtained from the deceased. They are not personally liable.

The legal representatives can enforce performance of the contract upon the other party or parties and their legal representatives.

Examples :

- (i) A promises to deliver goods to B on a certain day on payment of Rs. 1000. A dies before that day. A's representatives are bound to deliver the goods to B, and B is bound to pay Rs. 1000 to A's representatives.
- (ii) A promises to paint a picture for B by a certain day, at a certain price. A dies before the day. The contract cannot be enforced either by A's representative or by B.

ASSIGNMENT OF CONTRACTS

Assignment means transfer. The rights and liabilities of a party to a contract can be assigned under certain circumstances.

Assignment may occur (i) by act of parties or (ii) by operation of law. The rules regarding assignment of contracts are summarised below :

1. Contracts involving personal skill, ability, credit, or other personal qualifications, cannot be assigned. *Examples* : a contract to marry; a contract to paint a picture; a contract of personal service ; etc.

2. The obligations under a contract, *i.e.* the burden and the liabilities under the contract cannot be transferred. For example if X owes Y Rs. 100 he cannot transfer the liability to Z, and force Y to collect his money from Z.

Exception—In both cases 1 and 2, the parties to a contract may agree to replace the original contract by a new one under which the obligations of one of the parties is shifted to a new party. Thus in the example given above if Y agrees to accept Z as his debtor in place of X, the liability to pay the debt is transferred from X to Z. Such cases are known as Novation.

3. A contract may be performed through the agency of a competent person, if the contract does not contemplate performance by the promisor personally.—Sec. 40. But in this case the original party

remains responsible for the proper performance of the obligations under the contract.

4. The rights and benefits under a contract (not involving personal skill or volition) can be assigned. Thus if *X* is entitled to receive Rs. 500 from *Y*, he can assign his right to *Z*, whereupon *Z* will become entitled to receive the money from *Y*. But in this case the assignment is subject to all equities between the original parties. Thus if *Y* had already paid a portion of the debt to *X*, he will pay to *Z* correspondingly less.

5. The rights of a party under a contract may amount to an "actionable claim" or "a chose-in-action". Section 3 of the Transfer of Property Act defines an actionable claim as "a claim to any debt (except a secured debt) or to any beneficial interest . . . whether such claim or beneficial interest be existent, accruing, conditional or contingent". *Examples of actionable claims*: a money debt; book debts; the interest of a buyer of goods in a contract for forward delivery (*Jaffar Ali v. Budge Budge Jute Mills*⁴); an option to repurchase property sold; etc.

Actionable claims can be assigned, but only by a written document. Notice must be given to the debtor.

6. Assignment by operation of law occurs in cases of death or insolvency. Upon the death of a party his rights and liabilities under a contract devolve upon his heirs and legal representatives (except in the case of contracts involving personal qualifications). In case of insolvency, the rights and liabilities of the person concerned pass to the official assignee or the official receiver.

DEVOLUTION OF JOINT RIGHTS AND LIABILITIES

Two or more persons may enter into a joint agreement with one or more persons. *Example*: *A* and *B* jointly promise to pay Rs. 500 to *C* and *D*. In such cases, the question arises, who is liable to perform the contract and who can demand performance? The rules on the subject are stated below—Sections 42-45 :

1. When two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons must jointly fulfil the promise. Upon the death of one of the joint promisors, his liability devolves upon his legal representatives, and the legal representatives become liable to perform the contract jointly

with the surviving parties. If all the parties die, the liability devolves upon their legal representatives jointly.—Sec. 42.

The English law on the point is different. In case of joint promises, the liability to perform, devolves in England, upon the surviving promisors and the legal representatives of deceased promisors are not liable.

2. “When two or more persons make a joint promise, the promisee may, in the absence of express agreement to the contrary compel any one or more of such joint promisors to perform the whole of the promise.

Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

If any one of two or more joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.”—Sec. 43.

[Sec. 43 does not apply to Sureties. See *post* under Indemnity and Guarantee.]

Examples :

- (i) A, B & C jointly promise to pay D Rs. 3000. D may compel either A or B or C to pay him Rs. 3000.
- (ii) A, B, & C are under a joint promise to pay D Rs. 3000. C is unable to pay anything, and A is compelled to pay the whole. A is entitled to receive Rs. 1500 from B.
- (iii) A, B & C jointly promise to pay D Rs. 3000. C is compelled to pay the whole. A is insolvent but his assets are sufficient to pay one-half of his debts. C is entitled to receive Rs. 500 from A's estate and Rs. 1250 from B.

The English law is different. Under it “all joint contractors must be sued jointly for a breach of contract”. In India the promisee can choose against whom to proceed.

3. “Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or joint promisors; neither does it free the joint promisor so released from responsibility to the other joint promisor or joint promisors.”—Sec. 44.

The English law on this point is different. Release of one joint promisor under English law releases all the promisors but not in India.

4. When a person has made a promise to several persons jointly, then (unless a contrary intention appears from the contract) the right to claim performance rests on all the promisees jointly so long as all of them are alive. When one of the promisees dies the

right to claim performance rests with his legal representative jointly with the surviving promisees. When all the promisees are dead, the right to claim performance rests with their legal representatives jointly.—Sec. 45.

Example :

A in consideration of Rs. 500 lent to him by B & C, promises B & C jointly to repay them the sum with interest on a day specified. B dies. The right to claim performance rests with B's representative jointly with C during C's life and after the death of C with the representatives of B & C jointly.

RECIPROCAL PROMISES

A contract consists of reciprocal promises when one party makes a promise (to do or not to do something in the future) in consideration of a similar promise (to do or not to do something in the future) made by the other party. Reciprocal promises have been classified by Lord Mansfield in *Jones v. Barkely*⁵ under three categories, as follows :

1. *Mutual and Independent promises :* In such cases, each party must perform his promise without waiting for the performance or the readiness to perform of the other.

2. *Conditional and Dependent promises :* In such cases the performance of one party depends on the prior performance of the other party.

3. *Mutual and Dependent promises :* In such cases the promises have to be performed simultaneously.

Sections 51-54 of the Contract Act lay down the rules regarding the performance of reciprocal promises. They are stated below.

1. "When a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise."—Sec. 51.

Examples :

- (i) A & B contract that A shall deliver goods to B to be paid for by B on delivery. A need not deliver the goods, unless B is ready and willing to pay for the goods on delivery. B need not pay for the goods unless A is ready and willing to deliver them on payment.
- (ii) A & B contract that A shall deliver goods to B at a price to be paid by instalments, the first instalment to be paid on delivery. A need not deliver, unless B is ready and willing to pay the first instalment on delivery. B need not pay the first instalment, unless A is ready and willing to deliver the goods on payment of the first instalment.

2. "Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order; and where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires."—Sec. 52.

Examples :

- (i) A & B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.
- (ii) A & B contract that A shall make over his stock in trade to B at a fixed price, and B promises to give security for the payment of the money. A's promise need not be performed until the security is given, for the nature of the transaction requires that A should have security before he delivers up his stock.

3. "When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented; and he is entitled to compensation from the other party for any loss which he may sustain in consequence of the non-performance of the contract."—Sec. 53.

Example :

A & B contract that B shall execute certain work for A for a thousand rupees. B is ready and willing to execute the work accordingly, but A prevents him from doing so. The contract is voidable at the option of A; and, if he elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.

4. "When a contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract."—Sec. 54.

Examples :

- (i) A hires B's ship to take in and convey, from Calcutta to the Mauritius, a cargo to be provided by A, B receiving a certain freight for its conveyance. A does not provide any cargo for the ship. A cannot claim the performance of B's promise and must make compensation to B for the loss which B sustains by the non-performance of the contract.
- (ii) A contracts with B to execute certain builder's work for a fixed price, B supplying the scaffolding and timber

necessary for the work. *B* refuses to furnish any scaffolding or timber, and the work cannot be executed. *A* need not execute the work, and *B* is bound to make compensation to *A* for any loss caused to him by the non-performance of the contract.

- (iii) *A* contracts with *B* to deliver to him, at a specified price, certain merchandise on board a ship which cannot arrive for a month, and *B* engages to pay for the merchandise within a week from the date of the contract. *B* does not pay within the week. *A*'s promise to deliver need not be performed, and *B* must make compensation.
- (iv) *A* promises *B* to sell him one hundred bales of merchandise, to be delivered next day and *B* promises *A* to pay for them within a month. *A* does not deliver according to his promise. *B*'s promise to pay need not be performed, and *A* must make compensation.

5. "When persons reciprocally promise, firstly to do certain things which are legal, and secondly, under specified circumstances, to do certain other things which are illegal, the first set of promises is a contract, but the second is a void agreement."—Sec. 57. [See *ante*, p. 64].

THE TIME AND PLACE OF PERFORMANCE

The time and the place of performance of a contract are matters to be determined by agreement between the parties to the contract. In sections 46 to 50 of the Indian Contract Act certain general rules have been laid down regarding the time and place of performance. They are as follows :

1. "Where, by the contract, a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a reasonable time.

Explanation.—The question 'what is a reasonable time' is, in each particular case, a question of fact."—Sec. 46.

2. "When a promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business on such day and at the place at which the promise ought to be performed."—Sec. 47.

Illustration :

A promises to deliver goods at *B*'s warehouse on the first January. On that day *A* brings the goods to *B*'s warehouse, but after the usual hour for closing it, and they are not received. *A* has not performed his promise.

3. "When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business.

Explanation.—The question 'what is a proper time and place' is, in each particular case, a question of fact."—Sec. 48.

4. "When a promise is to be performed without application by the promisee, and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise, and to perform it at such place."—Sec. 49.

Illustration :

A undertakes to deliver a thousand maunds of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5. "The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions."—Sec. 50.

Illustration :

- (a) B owes A 2000 rupees. A desires B to pay the amount to A's account with C, a banker. B, who also banks with C, orders the amount to be transferred from his account to A's credit and this is done by C. Afterwards, and before A knows of the transfer, C fails. There has been a good payment by B.
- (b) A and B are mutually indebted. A and B settle an account by setting off one item against another, and B pays A the balance found to be due from him upon such settlement. This amounts to a payment by A and B respectively, of the sums which they owed to each other.
- (c) A owes B 2000 rupees. B accepts some of A's goods in deduction of the debt. The delivery of the goods operates as a part payment.
- (d) A desires B, who owes him Rs. 100, to send him a note for Rs. 100 by post. The debt is discharged as soon as B puts into the post a letter containing the note duly addressed to A.

EFFECT OF FAILURE TO PERFORM WITHIN STIPULATED TIME

The parties to a contract may stipulate that the contract is to be performed on a certain date or within a certain time. In such cases it is the duty of the court to consider the whole transaction and decide whether the parties really intended that the time fixed was to be an essential part of the agreement. In cases where this is so, time is said to be *the essence of the contract*. The mere fact that a time

is specified for the performance of a certain act is not by itself sufficient to prove that time is of the essence of the contract. Whether time is of the essence of the contract or not depends upon the nature of the property, upon the construction of the contract, and upon the objects which the parties had in mind in entering into it. In a series of cases it has been held that in mercantile contracts, the time of delivery of goods is of the essence of the contract but not the time of payment of the price. In many English cases it has been held that in contracts for the purchase of land, time is of the essence of the contract. In India, however, it has been held (*Jamshed v. Burjorji*⁶) that in contracts for the purchase of land the specified time is not of the essence of the contract unless there is a clear indication that it is to be so. In all cases it is for the court to decide what the parties really intended.

Section 55 of the Contract Act lays down certain rules regarding the effects of failure to perform a contract within the stipulated time. They are as follows :

1. In contracts where time is of the essence of the contract, if there is failure to perform within the fixed time, the contract (or so much of it as remains unperformed) becomes voidable at the option of the promisee.
2. In such cases, the promisee may accept performance after the fixed time but if he does so he cannot claim compensation unless he gives notice of his intention to claim compensation at the time of accepting the delayed performance.
3. In contracts where time is not of the essence of the contract, failure to perform within the fixed time does not make the contract voidable, but the promisee is entitled to get compensation for any loss occasioned to him by such failure.

RULES REGARDING APPROPRIATION OF PAYMENTS

When a debtor owes several distinct debts to the same creditor and makes a payment to the creditor, the question may arise against which debt the payment is to be appropriated. In England the law on the subject was laid down in *Clayton's case*.⁷ In India the rules regarding appropriation of payments are contained in Sections 58-61 of the Contract Act. The law on the point can be summarised as follows :

1. If the debtor at the time of making the payment expressly

⁶40 Bom 289

⁷ (1816) 1 Mer 572, 610

intimates that the payment is to be applied to the discharge of some particular debt, the payment if accepted, must be applied accordingly.

2. If there is no express appropriation, but there are circumstances which imply that the debtor intended appropriation to a particular debt, the debtor's intention must be followed, if the money is accepted.

Examples :

- (i) A owes B among other debts, Rs. 1000 upon a promissory note which falls due on 1st. June. He owes no other debt of that amount. On the 1st. June A pays to B 1000 rupees. The payment is to be applied to the discharge of the promissory note.
- (ii) A owes to B among other debts, the sum of Rs. 567. B writes to A and demands the payment of this sum. A sends to B Rs. 567. This payment is to be applied to the discharge of the debt of which B had demanded payment.

When both principal and interest is due, the debtor can stipulate that a particular payment made by him is to be appropriated to the principal, the interest remaining due. If the creditor accepts the payment he must also accept the debtor's appropriation. If he does not like to do so he must refuse to accept the payment.

3. If there is no express or implied appropriation by the debtor, the creditor may apply the money to any lawful debt which is due and payable by the debtor. He may even apply it to a debt which is barred by the law of limitation.

Example :

S was an unregistered dentist, who, according to the law in force in England, could not sue for performing a dental operation but could sue for materials supplied. S had a bill against P for £45 of which £20 was for performing an operation and £25 for materials supplied. P paid £20 without appropriating it. In an action by S, held, (1) S could appropriate the £20 towards his professional services because it was a lawful debt although irrecoverable and (2) he could make the appropriation for the first time while giving evidence in his suit. *Seymour v. Pickett.*^a

4. When neither the debtor nor the creditor makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are or are not barred by the law of limitation. If the debts are of equal standing (*i.e.* of the same date) the payment shall be applied in discharge of each proportionately.

The rules in re Hallett's estate : Suppose that a man has an account in a bank in which he keeps his own money as well as some

^a (1905) 1 K.B. 715

moneys of which he is a trustee. He makes a series of deposits and withdrawals, in the course of which some trust funds are misappropriated. In this case, the withdrawals are to be debited first to his own moneys and then to the trust funds; and the deposits are to be credited first to the trust fund and next to his own fund, whatever be the order of withdrawals and deposits. *In re Hallett's Estate*.⁹

EXERCISES

1. Examine the validity of reciprocal promises to do things legal and other things illegal. (C. A., May '52).
2. Consider the liabilities of joint promisors and explain the devolution of joint liabilities. (C. A., May '52; Nov. '55).
3. Write notes on: Tender; Assignment of Contracts.
4. State the rules regarding appropriation of payments. (C. A., Nov. '49; Nov. '55).

⁹ 18 Ch. D. 696

CHAPTER 12

TERMINATION OR DISCHARGE OF CONTRACTS

When the obligations created by a contract come to an end, the contract is said to be discharged or terminated. A contract may be discharged or terminated in any of the following ways :

- I. By performance of the promise or tender :
- II. By mutual consent cancelling the agreement or substituting a new agreement in place of the old.
- III. By subsequent impossibility of performance.
- IV. By operation of law—i.e. death, insolvency, or merger.
- V. By material alteration without the consent of the other parties.
- VI. By breach made by one party.

The cases on termination of contracts are discussed below.

I. TERMINATION BY PERFORMANCE

The obligations of a party to a contract come to an end when he performs his promise. Performance, by all the parties, of the respective obligations puts an end to the contract completely. This is the normal and natural mode of discharging a contract.

The *offer of performance* or tender has the same effect as performance. If a party to a contract offers to perform his promise but the offer is not accepted by the other party, the obligations of the first party are terminated.

II. TERMINATION BY MUTUAL AGREEMENT

By agreement of all parties, a contract may be cancelled or its terms altered or a new agreement substituted for it. Whenever any of these things happen, the old contract is terminated.

“If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed.”—Sec. 62.

Termination by mutual agreement may occur in any one of the following ways :

Novation—Novation occurs when a new contract is substituted for an existing contract, either between the same parties or between different parties. The essence of the novation of a contract lies in ~~the~~ the intention of the parties to supersede the old contract by the new.

Examples :

- (i) A is indebted to B and B to C. By mutual agreement B's debt to C and A's debt to B is cancelled and C accepts A as his debtor. There is novation.
- (ii) On an amalgamation of two insurance companies into a new company, the policy holders of the old companies can enforce their claims against the new company. The new company is substituted for the old companies.

Remission—Remission may be defined as the acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made. According to Section 63 of the Contract Act, "Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit." So in India a promisee may remit or give up a part of his claim and a promise to do so is binding even though there is no consideration for doing so.

Example :

A owes B Rs. 5000. A pays to B and B accepts in full satisfaction for the whole debt Rs. 2000. The old debt is discharged.

Accord and Satisfaction—These two terms are used in English law. According to English law, a promise to accept less than what is due under an existing contract, is not supported by any consideration and is therefore unenforceable. But an exception is made where the lesser sum is actually paid or the lesser obligation actually performed and accepted by the promisee. In such cases the old contract is discharged by what is called *accord and satisfaction*. Accord means the promise to accept less than what is due under the old contract. Satisfaction means the payment or the fulfilment of the lesser obligation. An accord is unenforceable; but an accord followed by satisfaction discharges the pre-existing obligation.

Example :

A owes B Rs. 5000. B agrees to accept Rs. 2000 in full satisfaction of his claim. This promise is unenforceable in English law. But when Rs. 2000 is actually paid and accepted, there is accord and satisfaction and the original debt is discharged.

The doctrine of accord and satisfaction is not applicable in India. According to section 63, a promisee may dispense with or remit wholly

or in part, the performance of the promise made to him. Therefore if the promisee agrees to accept Rs. 2000 in full satisfaction of a claim for Rs. 5000, the promise is enforceable.

Alteration—Alteration of a contract means change in one or more terms of the contract. Alteration is perfectly valid if it is done with the consent of all the parties to the contract.

Rescission—Rescission means cancellation of all or some of the terms of a contract. The rescission of a contract may occur under various circumstances :

1. It may be done by mutual consent.—Sec. 62.
2. Where a party to a contract fails to perform his obligations, the other party can rescind the contract without prejudice to his rights to receive compensation for breach of contract.
3. In a voidable contract, one of the parties has the option of rescinding it.

Examples :

- (i) A promises to deliver certain goods to B on a certain date. Before the date of performance A and B mutually agree that the contract will not be performed. The parties have rescinded the contract.
- (ii) X was induced to enter into an agreement by coercion. He can rescind the agreement.

Suit for Rescission : Section 35 of the Specific Relief Act (Act 1 of 1377) provides that. "Any person interested in a contract in writing may sue to have it rescinded." The court may grant rescission in the following cases :

- (a) When the contract is voidable or terminable by the plaintiff;
- (b) Where the contract is unlawful for causes not apparent on its face and the defendant is more to blame than the plaintiff; and
- (c) Where a decree for specific performance of a contract of sale, or of a contract to take a lease, has been made and the purchaser or the lessee makes default in payment of the purchase money or other sums which the court has ordered him to pay.

Rescission may be by act of party. It is not necessary, save in exceptional cases, to file a suit for the purpose. Section 66 of the Indian Contract Act provides that, "The rescission of a voidable contract may be communicated or revoked in the same manner, and subject to the same rules, as apply to the communication or revocation of a proposal".

Waiver—Waiver means the intentional relinquishment of a right which a person is entitled to. A party to a contract may waive his rights under the contract, whereupon the other party is released from his obligations.

Merger—When a superior right and an inferior right coincide and meet in one and the same person, the inferior right vanishes into the superior right. This is known as merger.

Example .

A man holding property under a lease, buys the property. His rights as a lessee vanish. They are merged into the rights of ownership which he has now acquired.

*II. SUBSEQUENT OR SUPERVENING IMPOSSIBILITY

A contract which at the time it was entered into was impossible to perform, is void *ab initio* and creates no rights and obligations, e.g., a promise to ride a horse to the moon.

A contract, which at the time it was entered into, was capable of being performed, may subsequently become impossible to perform or unlawful. In such cases the contract *becomes void*. This is known as the *doctrine of Supervening Impossibility*.

“A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.”—Sec. 56, para 2.

Supervening impossibility may occur in many ways, some of which are explained below :

1. **Destruction of an object necessary for the performance of the contract.**

Examples :

- (i) A music hall was let for a series of concerts on certain days. The hall was burnt down before the date of the first concert. The contract was held to be void. *Taylor v. Caldwell*.¹ Blackburn J. in this case observed as follows, “In contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance”.
- (ii) A person contracted to deliver a part of a specific crop of potatoes. The potatoes were destroyed by a pest through no fault of the party. The contract was held to be discharged. *Howell v. Coupland*.²

2. **Change of Law.**—The performance of a contract may become

¹ (1862) 3 B & S 826

² (1876) 1 Q.B.D. 258

unlawful by a subsequent change of law. In such cases, the original contract becomes void.

Examples :

- (i) A sold to B a specific parcel of wheat in a warehouse. Before delivery, the wheat was requisitioned by the Government under statutory powers. The delivery being now legally impossible, the contract was discharged. *Re Shipton, Anderson & Co.*^{*}
- (ii) X, who was governed by Hindu Law and who already had a wife promises to marry Y. Then the Special Marriage Act is passed prohibiting polygamous marriage. The contract to marry becomes void.

3. **The non-existence of a state of things, the continued existence of which formed the basis of the contract.** When a contract is entered into on the basis of the continued existence of a certain state of things, the contract is discharged if the state of things changes.

Examples :

- (i) A & B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void (illustration (b) of section 56).
- (ii) H hired a room from K for two days with the object (as both parties knew) of using the rooms to view the coronation procession of Edward VIII although the contract contained no reference to the procession. Owing to the king's illness the procession was abandoned. Held, that the contract was discharged and H was excused from paying rent for the room as the existence of the procession was the basis of the agreement. *Krell v. Henry.*⁴

The principle laid down here has been supported in some cases on the ground that every agreement presumes the existence of a certain state of things on the basis of which the agreement was entered into. The continued existence of the same state of things is a condition precedent to the performance of the contract. Obviously the contract fails if there is a failure of the condition precedent.

4. **Personal incapacity.** Where the personal qualification of a party is the basis of the contract the contract is discharged in cases of personal incapacity.

Example :

A contracts to act at a theater for ~~six months~~ in consideration of a sum paid in advance by H. On several occasions A is too ill to act. The contract to act on these occasions becomes void. - *Robinson v. Davison.*

5. **Outbreak of War.** A contract entered into during war with an alien enemy is void *ab initio*. A contract entered into before the

^{*} (1915) 2 K.B. 676

⁴ (1903) 2 K.B. 740

war commenced between citizens of countries subsequently at war, remains suspended during the pendency of the war. After the termination of the war, the contract revives and may be enforced.

The above rules regarding the effect of war on contracts were formulated by English judicial decisions and are applicable to India. But the following exceptions are to be noted :

(i) In India there may be a valid contract with an enemy alien during war, if the Central Government specifically permits it.

(ii) Contracts entered into before the outbreak of the war will be abrogated and not merely suspended, if they amount to aiding the enemy in the pursuit of war, *Esposito v. Bowden*⁵; or if they are of such a character that they cannot remain suspended e.g. when the contract involves the continuous performance of mutual duties.

✱ **The Doctrine of Frustration.** In English cases it has been held that when the common object of a contract can no longer be carried out, the court may declare the contract to be at an end. This is known as the Doctrine of Frustration. The doctrine developed in England under the guise of reading implied terms in contracts. The idea was that the parties could not have intended to stick to a contract the purpose of which has disappeared.) In a recent case on the subject, *British Movietonews, Ltd. v. London and District Cinemas Ltd.*⁶ the House of Lords based the doctrine upon the principle of construction. Where the court gathers 'as a matter of construction that the contract itself contained impliedly or expressly a term, according to which it would stand discharged on the happening of certain circumstances, the dissolution of the contract would take place under the terms of the contract itself.

In *Satyabrata Ghose v. Mugniram Bangur and Co. and Another*⁷, the Supreme Court of India discussed the English cases relating to frustration and came to the following conclusions :

✓ "The doctrine of frustration of contract comes into play when a contract becomes impossible of performance, after it is made, on account of circumstances beyond the control of the parties. It is really an aspect or part of the law of discharge of contract by reason of supervening impossibility or illegality of the act agreed to be done and hence comes within the purview of Sec. 56 of the Indian Contract Act."

"The word 'impossible' in Sec. 56 of the Indian Contract Act

⁵ 7 E & B 763

⁶ (1952) A.C. 166

⁷ (1954) S.C.A. 187

has not been used in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view of the object and purpose which the parties had in view; and if an untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain, it can be said that the promisor finds it impossible to do the act which he promised to do."

Examples :

- (i) Some English merchants contracted to sell machinery to Polish buyers. Before delivery was due, Germany occupied Poland. It was held that the contract was discharged by frustration. *Fibrosa etc., v. Fairbairn etc.*²
- (ii) An agreement was entered into for the sale of land subject to the condition that the seller would do some development work on the land. Before the work could be completed the land was requisitioned by the Government for war purposes. Held, the contract was not frustrated. *Satyabrata Ghose v. Mugniram Bangur & Co. and Another.*³

**** Cases which do not come within the Principle of Supervening Impossibility.** Apart from the cases mentioned above, impossibility does not discharge contracts. Some illustrations are given below.

1. Difficulty of performance does not excuse performance.

Examples :

- (i) A sold to B a certain quantity of Finland timber to be delivered between July and September, 1914. No deliveries were made before August when war broke out and transport was disorganised so that A could not bring any timber from Finland. Held, B was not concerned with the way in which A was going to get timber and therefore the impossibility of getting timber from Finland did not excuse performance. *Blackburn Bobbin Co. v. Allen & Sons.*¹
- (ii) X promised to send certain goods from Bombay to Antwerp in September. In August war broke out, and shipping space was not available except at very high rates. Held, the increase of freight rates did not excuse performance.²

2. A wholesale dealer's contract to deliver goods is not discharged because a manufacturer has not produced the goods concerned. He is liable to pay damages.³ Similarly increase of wages or prices of raw materials or unseasonable weather does not excuse performance. The reason is that if the parties did not stipulate to the contrary, they must have intended to take the risk of occurrences like these.

² (1943) A. C. 2

³ (1954) S. C. A. 187

¹ (1918) 2 K.B. 467

² 40 Bom. 301

³ 47 Bom. 344

3. **Strikes and lock-outs and civil disturbances** like riots do not terminate contracts unless there is a clause in the contract providing that in such cases the contract is not to be performed or that the time of performance is to be extended.

Examples :

(i) The lessee of certain salt pans, failed to repair them according to the terms of his contract, on the ground of a strike of the workmen. Held, a strike of workmen is not sufficient reason to excuse performance of a term of the contract.⁴

(ii) A contract was entered into between two London merchants for the sale of certain Algerian goods. Owing to riots and civil disturbances in that country, the goods could not be brought. Held, no excuse for non-performance of the contract. Jacob v. Credit Lyonnais.⁵

*4. When there are several purposes for which a contract is entered into, *failure of one of the objects* does not terminate the contract.

Example :

X agreed to let out a boat to Y for the purpose of viewing a naval review to be held on the occasion of the Coronation of Edward VIII and to ~~cruise round the fleet~~. Owing to the king's illness the naval review was abandoned but the fleet was assembled and the boat could have been used to cruise round the fleet. Held, the contract was not terminated. Herne Bay Steamboat Co. v. Hutton.⁶

(*) THE EFFECTS OF SUPERVENING IMPOSSIBILITY

1. Section 56 (para 2) provides that when the performance of a contract becomes subsequently impossible or illegal, the contract becomes void.

*2. Section 65 provides that when a contract becomes void, any person who has received any advantage under it must restore it, or make compensation for it, to the person from whom he received it. [See *post* under Restitution.]

③ Section 56 (para 3) provides that, "where one person has promised to do something which he knew, or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise."

⁴ 52 Bom. 142

⁵ 12 Q. B. D. 589

⁶ (1903) 2 K. B. 740

Example :

A contracts to marry B being already married to C, and being forbidden by the law to which he is subject to practise polygamy. A must make compensation to B for any loss caused to her by the non-performance of his promise.

IV. TERMINATION BY OPERATION OF LAW

A contract terminates by operation of law in case of death, insolvency, and merger.

Death—In contracts involving personal skill or ability, death terminates the contract. In other cases, the rights and liabilities pass on to the legal representatives of the dead man.

Insolvency—Upon insolvency, the rights and liabilities of the insolvent are, with certain exceptions, transferred to an officer of the court, known as the Official Assignee in Calcutta and other presidency towns and as Official Receiver in other areas.

Merger—See under II.

V. TERMINATION BY MATERIAL ALTERATION

If the document containing the terms of a contract is *materially altered* by a party to the contract, *without the consent* of the other parties, the contract is discharged and cannot be enforced any more.

The term 'material alteration' means a change which affects or alters, in a significant manner, the rights and liabilities of the parties. **Example :** A change in the amount of money to be paid; the time of payment; the place of payment; the names of the parties etc. These changes involve tampering with the document wherein the terms of the contract have been written down. A document which has been tampered with in such a way is not admissible in evidence and the contract recorded there naturally becomes unenforceable. In case of a material alteration, the party making the alteration cannot ask the court to enforce the agreement as it stood before the alteration. Thus if a promissory note for Rs. 500 has been changed to one for Rs. 5000, the note becomes bad in law and the creditor cannot even ask for a decree for Rs. 500 only.

An alteration which does not affect the rights and liabilities of the parties or which are made to carry out the common intention of the parties has no effect on the validity of the contract. **Examples :** correcting a clerical error in figures, correcting the spelling of a name etc.

VI. TERMINATION BY BREACH OF CONTRACT

Breach of contract ~~may~~ arise in two ways : (i) by anticipatory breach and (ii) by actual breach.

Anticipatory Breach of Contract. Anticipatory breach of contract occurs when a party repudiates his liability under the contract *before the time for performance is due* or when a party by his own act *disables himself* from performing the contract.

Examples :

- (i) A enters into a contract to supply B with certain articles on the 1st of June. Before 1st June he informs B that he will not be able to supply the goods.
- (ii) W agrees to sing at L's theater on and from a certain date. Before that date she enters into a long term contract to sing at a different theater.
- (iii) X agrees to marry Y. Before the agreed date of marriage, he marries Z.

Consequences of Anticipatory Breach. When anticipatory breach occurs, the aggrieved party can take the following steps :

- (i) He can treat the contract as discharged, so that he is no longer bound by any obligations under the contract; and,
- (ii) He can immediately adopt the legal remedies available to him for breach of contract, *viz.* file a suit for damages or specific performance or injunction.

Anticipatory breach of contract does not by itself discharge the contract. The contract is discharged only when the aggrieved party chooses to treat it as discharged, *i.e.* when he accepts the repudiation of the contract. If he does not accept the repudiation, the contract continues to exist and may be performed by the other party, if possible. But if the repudiation is not accepted and, subsequently an event happens which discharges the contract legally (*e.g.*, a supervening impossibility) the aggrieved party loses his right to sue for damages.

Examples :

- (i) A agrees to employ B as a clerk, the service to commence from 1st June. On 20th May he informs B that his services will not be required. On 21st May B files a suit for damages. He is entitled to do so even though the date of performance of the contract has not arrived.
- (ii) X agreed to load a cargo of wheat on Y's ship at Odessa within a certain number of days. When the ship arrived X refused to load the cargo. Y did not accept the refusal and continued to demand a cargo. Before the last date of loading had expired, the Cremean War broke out, rendering the performance of the contract illegal. Held, the con-

tract was discharged and Y cannot sue for damages. Avery v. Bowden.⁷

Actual Breach of Contract. Actual breach of contract occurs when during the performance of the contract or at the time when the performance of the contract is due, one party either fails or refuses to perform his obligations under the contract.

Examples :

- (i) A agrees to deliver to B, 5 tons of sugar on 1st June. He fails to do so on 1st June. There is breach of contract by A.
- (ii) A agrees to deliver to B, 5 tons of sugar on 1st June. On 1st June he tenders the sugar but B (for no valid reason) refuses to accept delivery. There is breach of contract by B.
- (iii) C agreed to supply a railway company with 3900 tons of railway chairs. After 1787 tons had been delivered the company told C that no more will be required. There is breach of contract by the company. Cort v. Ambergate Railway Company.⁸

Effect of neglect of promisee to afford promisor reasonable facilities for performance. "If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby."—Sec. 67.

Illustration :

A contracts with B to repair B's house. B neglects or refuses to point out to A the places, in which his house requires repair. A is excused for the non-performance of the contract if it is caused by such neglect or refusal.

*** Remedies of Breach of Contract.** When a breach of contract occurs, the aggrieved party or the injured party becomes entitled to the following reliefs :

1. *Rescission of the contract.* The aggrieved party is freed from all his obligations under the contract.

Example :

A promises to deliver 5 tons of sugar to B on a certain date and B promises to pay the price on receipt of the goods. A does not deliver the goods on the appointed day. B need not pay the price.

2. *Suit for Damage.* The aggrieved party is entitled to receive compensation for any loss or damage caused to him by the breach of contract and can file a suit for getting a decree for damages.

⁷ (1856) 6 E & B 965

⁸ (1851) 17 Q.B. 127

13. *Suit upon Quantum Meruit.* When a contract has been partly performed the aggrieved party can, under certain circumstances, file a suit for the price of the services performed before breach of contract.

4. *Specific performance of the contract.* In certain special cases the court can direct a party to perform the contract according to the agreed terms.

5. *Injunction.* Under certain circumstances the court can issue an order upon a party whereby he is prohibited from doing something which amounts to a breach of contract.

The provisions of law regarding the reliefs listed above are discussed below.

DAMAGES

When a contract is broken the injured party can claim damages from the other party. Damages allowed by the courts may be of different types as follows :

Compensatory Damages. Compensatory damages are damages calculated in such a way as to compensate or make up the loss suffered by a party.

Nominal Damages. Contemptuous Damages. Where the court finds that the party has not actually suffered much damage or when the court is of opinion that the breach complained of was too insignificant or petty, the court allows a petty sum like one pice or one penny as damages to the plaintiff. These are called nominal damages or contemptuous damages.

Exemplary, Punitive or Vindictive Damages. The court may allow damages exceeding the actual loss suffered by way of punishment. These are called exemplary, punitive or vindictive damages. Such damages are unusual. In English courts exemplary damages are usually given in cases of breach of contract of marriage and against bankers refusing to pay traders' cheques where there are sufficient funds of the trader in the bank.

RULES REGARDING THE AMOUNT OF DAMAGES

The principles, to be followed by the courts in determining the amount of damages, are laid down in Sections, 73 to 75 of the Contract Act.

Section 73 (para 1) provides that in cases of breach of contract the injured party is entitled to receive compensation for any loss or

damage which arose naturally from the breach or which the parties knew to be likely to arise from the breach.

"When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it."—Sec. 73, para 1.

The leading rules on the subject of amount of damages can be summarised as follows :

1. Ordinarily, the aggrieved party is entitled to recover by way of compensation, only the *actual loss* suffered by him.

2. In calculating actual loss, the court will take into account only such loss as may be *fairly and reasonably* considered as arising *naturally* and in the *usual course of things* from the breach. Remote damages *i.e.* damages for remote consequences are usually not allowed.

Examples :

- (i) X, a carrier, was entrusted with the delivery of a machine part to Y, a manufacturer. The delivery was delayed. Y claimed from X compensation for the wages of workers and depreciation charges which were incurred during the period the factory was idle for the delayed delivery and for loss of profits which might have been made if the factory was working. The first two items were allowed because they were natural consequences of the breach. The last item, loss of profits, was disallowed because it was a remote consequence. *Hadley v. Baxendale.*⁹
- (ii) A contracts to sell and deliver 50 maunds of saltpetre to B, at a certain price to be paid on delivery. A breaks his promise. B is entitled to receive from A by way of compensation the sum, if any, by which the contract price falls short of the price for which B might have obtained 50 maunds of saltpetre of like quality at the time when the saltpetre ought to have been delivered. (Illustration (a) to Sec. 73).
- (iii) A contracts to pay a sum of money to B on a day specified. A does not pay the money on that day. B in consequence of not receiving the money on that day is unable to pay his debts and is totally ruined. A is not liable to make good to B anything except the principal sum he contracted to pay, together with interest up to the day of payment. (Illustration (n) to Sec. 73).
- (iv) A hires B's ship to go to Bombay, and there take on board, on the first of January, a cargo which A is to provide, and to bring it to Calcutta, the freight to be paid when earned. B's ship does not go to Bombay, but A has opportunities of procuring suitable conveyance for the cargo upon terms as

advantageous as those on which he had chartered the ship. A avails himself of those opportunities, but is put to trouble and expense in doing so. A is entitled to receive compensation from B in respect of the trouble and expense. (Illustration (b) to Sec. 73).

3. The court may allow remote damages, *i.e.* damages not arising naturally from the breach, if such damages may reasonably be supposed to have been in the contemplation of both the parties at the time they made the contract.

Damages coming within this category are sometimes called, **"Special Damages"**.

Examples :

- (i) A delivers to B, a common carrier, a machine to be conveyed, without delay to A's mill, *informing B that his mill is stopped for want of the machine*. B unreasonably delays the delivery of the machine and A, in consequence, loses a profitable contract with the government. A is entitled to receive from B, by way of compensation, the average amount of profits which would have been made by the working of the mill during the time that delivery of it was delayed, but not the loss sustained through the loss of the government contract. (Illustration (i) to Sec. 73).
- (ii) P bought from L some copra cake. P sold the cake to B, who sold it to various dealers, who in turn sold it to farmers, who used it for feeding cattle. The copra cake was poisonous and the cattle fed on it died. The various buyers filed suits against their sellers and obtained damages. The various sellers filed suits against P and obtained damages. P claimed from L the damages and costs he had to pay. Held, as it was within the contemplation of the parties that the copra cake was to be used for feeding cattle, L was liable to pay damages. *Pinnock Bros. v. Lewis & Peat Ltd.*¹

4. The general rule is that, subject to the rules stated above, the injured party is to be placed in the same financial position as he would have been in, if the other party had duly carried out the contract. "If a contract is broken, law will endeavour, so far as money can do it, to place the injured party in the same position as if the contract has been performed."

5. The injured party is entitled to get the costs of getting the decree for damages.

6. It is the duty of the injured party to minimise the loss as much as possible. The law imposes on the plaintiff "the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming any part of the damages which is due to his neglect to take such steps." (Lord Haldane.²)

¹ (1923) 1 K.B. 690

² in (1912) A.C. 689

Example :

The plaintiff took a shop on lease and paid an advance. The defendant could not give him possession and the plaintiff chose to do no business for 8 months though there were other shops available in the vicinity. Held, he was entitled only to a refund of his advance as his duty was to minimise damages and he could have done so by taking another shop. *Neki v. Pirbhu*.³

7. If in a contract a sum of money is named as the amount to be paid in case of breach, or if the contract contains any stipulation by way of penalty for failure to perform the obligations, the court will allow *reasonable compensation, not exceeding the sum named*.—Sec. 74.

Example :

A contracts with B to pay B Rs. 1000 if he fails to pay B Rs. 500 on a certain day. A fails to pay B Rs. 500 on that day. B is entitled to recover from A such compensation, not exceeding Rs. 1000, as the court considers reasonable.

8. Difficulty of calculating damages is no ground for refusing damages. The court must make an assessment of loss and pass a decree for it.

Example :

H organised a beauty competition in which 50 ladies were to be selected by votes of the readers of certain newspapers. H would select 12 out of the 50 and secure theatrical jobs for them. C was one of the 50 and by H's breach of contract was prevented from being present when the final selection was made. Held, C was entitled to damages even though it was difficult to calculate them. *Chaplin v. Hicks*.⁴

Liquidated Damages and Penalty. A contract sometimes contains a clause in which a sum of money is named as the amount payable in case of breach of contract. In such cases the question arises whether the courts of law will accept this figure as the measure of damage.

According to English law, the amount of money payable is interpreted either as liquidated damages or as a penalty. It is considered to be liquidated damages when the amount is fixed by the parties on the basis of a *reasonable* estimate of the *probable actual loss* which a party will suffer in case of breach. On the other hand, the amount fixed is considered to be a penalty if it is not based upon a reasonable calculation of actual loss but is fixed by way of *punishment* and as a *threat*. Suppose that a contractor agrees to complete the building of a house by 1st June and promises to pay Rs. 50 per day as damages for each day of default beyond the prescribed day of

³ 100 I.C. 662

⁴ (1911) 2 KB., 786

completion. If the figure Rs. 50 was arrived at after calculating the actual loss which the house-owner will suffer for the breach of contract, it is liquidated damages. If the actual damage is considerably less and the amount was fixed in order to threaten the contractor it is a penalty.

In case of liquidated damages, English courts allow only the amount stipulated, never more or less even though it is shown that the actual loss is different from the amount mentioned. Penalty clauses, however, are treated as invalid. The court allows only reasonable compensation by way of damages,

In India, the distinction between liquidated damages and penalty is not recognised. Section 74 of the Contract Act lays down that if the parties have fixed what the damages will be, the courts will never allow more. But the court may allow less. A decree is to be passed only for reasonable compensation, not exceeding the sum named by the parties.

A stipulation that increased interest will be paid from the date of default of performance may be considered a penalty clause and disallowed by the courts.

There is one exceptional case provided for by Section 74. "When any person enters into any bail bond, recognizance or other instrument of the same nature, under the provisions of any law, or under the orders of the Central Government or of any State Government gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the whole sum mentioned therein."

When can interest be claimed as damages? When under a contract a party is entitled to receive a sum of money and default is made in payment, the question arises whether the injured party is entitled to receive interest on it. It has been held that interest will be allowed only in the following cases :

- (i) where there is an agreement, express or implied, to pay interest;
- (ii) where there is a custom or usage of trade to that effect; and
- (iii) under the provisions of the Interest Act of 1839.

The Interest Act provides that the court may allow interest on all debts and ascertained sums in two cases : (i) where the money is payable on a fixed date by a written instrument: from the fixed date of payment; (ii) where there is no fixed date of payment: from the

date of demand of payment in writing, specifying that interest will be payable from the date of demand.

In *Trojan & Co. v. Chettier*⁵ it was held that interest on damages is payable when there was fraud in the contract.

QUANTUM MERUIT

The phrase "Quantum Meruit" means "as much as is merited." A person can, under certain circumstances, claim payment for work done or goods supplied without any contract and in cases where the original contract has terminated by breach of contract by one party or has become void for some reason. This is known as the Doctrine of Quantum Meruit.

Anson, in his *Law of Contract*, states that the Doctrine of Quantum Meruit comes into operation in three different ways, as follows :

1. Where there is a breach of contract, the injured party is entitled to claim reasonable compensation for what he has done under the contract.

Examples :

- (i) P agreed to write a book to be published by instalments in a magazine owned by C. After a few instalments were published, the magazine was abandoned. P is entitled to get damages for breach of contract and payment quantum meruit for the part already published. *Planche v. Colburn*.⁶
- (ii) A contractor is engaged by X to build a two-storeyed house. After a part is constructed, he prevents the contractor from working any more. The contractor is entitled to get reasonable compensation for the work done, in addition to what he may be allowed by the court as damages for breach of contract.

2. When a contract is discovered to be unenforceable for some technical reason, any person who has done something under the contract, is entitled to reasonable compensation. This case is provided for by Section 65 of the Act. (See below.)

Example :

C was employed as managing director of a company by the board of directors of the company under a written contract. The contract was found to be void because the directors who constituted the board were unqualified. C actually worked as managing director for some time. It was held that he was entitled to remuneration as quantum meruit. *Craven-Ellis v. Canons Ltd.*⁷

⁵ (1954) S.C.A. 710

⁶ (1831) 8 Bing 14

⁷ (1936) 2 K.B. 403

3. In certain cases the law presumes an implied agreement to pay for services rendered, for example, when work is done or goods are supplied by a person without any intention to do so gratuitously and the benefit of the same is enjoyed by the other party. This case is provided for by Section 70 of the Contract Act.

Example :

A, a trader leaves certain goods with B by mistake, not intending to do so gratuitously. B uses the goods. He must pay for them.

According to English decided cases, the Doctrine of Quantum Meruit is subject to certain limitations :

1. Where a contract is not divisible into parts and a lump sum of money is promised to be paid for the entire work, part performance does not entitle a party to claim payment quantum meruit.

Example :

A sailor was appointed on a ship for a voyage from Jamaica to Liverpool on a lump sum payment of 30 guineas. He died when only two-thirds of the voyage was completed. Held, his legal representatives could not recover anything. *Cutter v. Powell*.^a

2. Nothing can be recovered for quantum meruit when there is no evidence of an express or implied promise to pay for work already done.

3. A person guilty of breach of contract cannot claim payment on quantum meruit.

SPECIFIC PERFORMANCE

Under certain circumstances, a person aggrieved by breach of contract can file a suit for specific performance, *i.e.* for an order by the court upon the party guilty of breach of contract directing him to perform what he promised to do. Specific performance is a discretionary remedy which is allowed only in a limited number of cases. Rules regarding the granting of this relief are contained in the Specific Relief Act of 1877.

Generally speaking, specific performance is directed only in cases where monetary compensation is not an adequate remedy. For example, in contracts for the sale of a particular house or some rare article, monetary compensation is not enough because the injured party will not be able to get an exact substitute in the market. In such cases specific performance may be directed.

Specific performance is not allowed in cases where monetary compensation is an adequate relief. It is also not allowed in contracts

^a 101 E.R. 573

of a personal nature, *e.g.*, a contract to marry or a contract to paint a picture. Where it is not possible for the court to supervise the performance of the contract, *e.g.*, a building contract, specific performance is not granted.

INJUNCTION

Injunction means an order of the court. In cases of breach of contract, the injured party can, under certain circumstances, get a negative injunction, *i.e.* an order prohibiting a party from doing something. Injunctions are usually granted to enforce negative stipulations in cases where damages are not adequate relief. It is particularly appropriate in cases of anticipatory breach of contract.

Examples :

- (i) G agreed to buy the whole of the electric energy required for his house from a certain company. This was interpreted as a promise not to buy electricity from any other company. He was therefore restrained by an injunction from buying electricity from any other company. *Metropolitan Electric Supply Company v. Ginder*.⁰
- (ii) N, a film actress agreed to act exclusively for Warner Bros, for one year. During the year she contracted to act for X. Held, she could be restrained by an injunction from acting for X. *Warner Bros. v. Nelson*.¹ It is to be noted that in this case an order directing N to act for Warner Bros. (specific performance of the contract) was not passed because the contract was of a personal nature and performance could not have been supervised by the courts.

RESTITUTION OF BENEFIT

Section 64 of the Contract Act provides that when a person, at whose option a contract is voidable, rescinds such contract, he must restore to the other party any benefit which he may have received from him. For example, when a contract for the sale of a house is avoided on the ground of undue influence, any money received on account of the price must be refunded.

Section 65 provides that when an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it or to make compensation for it, to the person from whom he received it.

Examples :

- (i) A pays B Rs. 1000 in consideration of B's promising to marry C, A's daughter. C is dead at the time of the promise. The agreement is void but B must repay A Rs. 1000.

⁰ (1901) 2 Ch. 799

¹ (1937) 1 K.B. 209

- (ii) A, a singer contracts with B the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her a hundred rupees for each night's performance. On the sixth night A wilfully absents herself from the theatre and B, in consequence, rescinds the contract. B must pay A for the five nights on which she had sung. (B can of course claim damages against A for breach of contract.)

This section applies to contracts 'discovered to be void' and contracts which 'become void.' It does not apply to contracts which are known to be void. Thus if A pays Rs. 100 to B to beat C, the money is not recoverable.

The expression "become void" is interpreted liberally. In *Muralidhar Chatterjee v. The International Film Co.*² it was held that when one party rescinds a contract for the default of another he is entitled to damages (if he has suffered any) but he must restore to the other party any advantage he has received under the contract.

Under English law, as it stood prior to 1942, the principle of restitution of benefit was not applied. When a contract became void it was not obligatory to restore any benefit obtained thereunder. But in *Fibrosa etc. v. Fairbairn etc.*,³ the House of Lords applied the principle of restitution in a case where the performance of a contract was excused on the ground of frustration.

EXERCISES

1. What is the difference between Penalty and Liquidated Damages? (C.U. '54, '56, '61; C.A., Nov. '52).
2. What is the difference between "alteration" and "novation of contracts"? (C.U. '54).
3. In what cases is the plea of impossibility of performance of contract recognised? (C.A., May '51).
4. What do you understand by the doctrine of Accord and Satisfaction? (C.A., May '54).
5. Mention the various ways in which a contract may be terminated. (C.U. '60).
6. What are the principles usually followed to assess damages for breach of contract? (C.A., Nov. '51).
7. Define: Special Damages; Exemplary Damages; Nominal Damages; Liquidated Damages. (C.A., Nov. '54).
8. What are the remedies for the breach of a contract? (C.A., '59).
9. What remedies are available to a party against the other on the breach of a contract? (C.U., B.Com. '62).
10. "If a contract is broken, law will endeavour, so far as money can do it, to place the injured party in the same position as if the contract has been performed." Discuss. (C.U. '58).

² 37 C.W.N. 497

³ (1942) 2 A.E.R. 122

CHAPTER 13

QUASI-CONTRACTS

When one person obtains a benefit at the expense of another and the circumstances are such that he ought, equitably, to pay for it, the law will compel payment, even though there is no contract between the parties by which payment is promised. The parties will be put in the same position as they would have occupied if there was a contract between them. Such cases are called *quasi-contracts* because the relationship between the parties in such cases resembles those created by contracts. Sections 68-72 of the Contract Act describe the cases which are to be deemed quasi-contracts under the Indian law.

① Section 68. "If a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person."

Illustrations :

- (a) A supplies B, a lunatic, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property.
- (b) A supplies the wife and children of B, a lunatic, with necessaries suitable to their condition in life. A is entitled to be reimbursed from B's property.

This section covers the case of necessaries supplied to a minor and other incapable persons (*e.g.* a lunatic) and to persons whom the incapable person is bound by law to maintain (*e.g.* his wife and minor children). The things supplied must come within the category of necessaries. The price to be paid is reasonable price—not the price which the incapable person might have "agreed to" (legally speaking an incapable person cannot agree to anything). Only the property of the incapable person is liable. He is not personally liable.

2. Section 69. "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other."

Illustration :

B holds land in Bengal, on a lease granted by A, the zaminder. The revenue payable by A to the Government being in arrear,

his land is advertised for sale by the Government. Under the revenue law, the consequence of such sale will be the annulment of B's lease. B to prevent the sale and the consequent annulment of his own lease, pays to the Government the sum due from A. A is bound to make good to B the amount so paid. (Illustration to Sec. 69.)

3. Section 70. "Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered."

Illustrations:

- ✓(a) A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay for them.
- (b) A saves B's property from fire. A is not entitled to compensation from B if the circumstances show that he intended to act gratuitously.

4. Section 71. "A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee."

The finder of goods must take reasonable care for the protection and preservation of the goods, *i.e.* such care as would have been taken by a man of ordinary prudence. He is entitled to receive from the true owner, all expenses incurred by him for protecting and preserving the goods. He has a lien on the goods for the money so spent, *i.e.* he can refuse to return the goods to the true owner until these moneys are paid. But he cannot file a suit for the recovery of such sums. His only remedy is to keep the goods in his possession. The finder is entitled to sell the goods if they are perishable. In case of non-perishable goods, he can sell them if the costs and expenses incurred by him amount to two-thirds of the value of the goods. The true owner is entitled to get the balance of sale proceeds, after repayment of the costs and expenses.

Only the true owner can recover possession from the finder. If the true owner is not found, the finder can retain the goods and no other person can claim it from him.

(See also under Bailment)

5. Section 72. "A person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it.

Illustrations :

- (a) A and B jointly owe 100 rupees to C. A alone pays the amount to C, and B, not knowing this fact, pays 100 rupees over again to C. C is bound to repay the amount to B.
- (b) A railway company refuses to deliver up certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

EXERCISES

1. What are quasi-contracts? Enumerate the quasi-contracts dealt with under the Indian Contract Act. (C.A., May '55).
2. What are the obligations and rights of a finder of goods? (C.A., May '51).

CHAPTER 14

INDEMNITY AND GUARANTEE

Contracts of Indemnity. Section 124 of the Contract Act defines a contract of indemnity as a contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.

Example :

A, contracts to indemnify B, against the consequences of any proceeding which C may take against B in respect of a certain sum of Rs. 200. This is a contract of Indemnity. A is called the *Indemnifier* and B the *Indemnity holder*.

Section 124 of the Indian Contract Act does not give an exhaustive definition of contracts of indemnity. The section includes (i) only *express promises* to indemnify and (ii) only those cases where the loss arises from the *conduct* of the promisor or of any other person. It does not include (i) *implied promises* to indemnify and (ii) cases where loss arises from accidents and events not depending on the conduct of any person.

It has been held in a number of cases in India that a duty to indemnify may arise by operation of law even in the absence of express agreements. A promise to indemnify may be either express or implied from the circumstances of the case. The illustration given above is an example of an *express promise* to indemnify. The following is an example of an *implied promise* to indemnify.

A broker forged the signature of the holder of a Government promissory note and endorsed it to the Bank of India. The bank got the note renewed from the Government. The holder sued the Government and recovered damages. The Government sued the bank for indemnity. The Privy Council decreed the suit, quoting with approval the following observations of Lord Halsbury¹ : "It is a general principle of law that when an action is done by one person at the request of another which act is not in itself manifestly tortious to the knowledge of the person doing it, and such act turns out to be injurious to the rights of a third party, the person doing it is entitled to indemnity from him who requested that it should be done."

¹ 65 I.A. 286

Under English law, contracts of indemnity cover a much wider field than that included in Section 124 of the Indian Contract Act. In England contracts of indemnity include promises, express and implied, to indemnify a person from loss caused by events or accidents which may not depend upon the conduct of any person. In a Bombay case it was held that, "Sections 124 and 125 of the Contract Act are not exhaustive of the law of indemnity and the courts here would apply the same equitable principles that the courts in England do." *Gajanan v. Moreshwar*.²

Rights of the Indemnity-holder. Section 125 of the Contract Act lays down that the indemnity-holder is entitled to get from the indemnifier :

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all costs which he may be compelled to pay in such suits (provided he acted prudently or with the authority of the indemnifier); and

(3) all sums which he may have paid upon compromise of such suit (provided the compromise was prudent or was authorised by the indemnifier).

It has been held that Section 125 is not exhaustive. The indemnity-holder may be entitled to other equitable reliefs also. It has also been held that the indemnity-holder can compel payment from the indemnifier even before he (the indemnity-holder) has met his liability. *Osman Jamal & Sons v. Gopal*.³

Contracts of Guarantee. A contract of guarantee is a contract to perform the promise or discharge the liability, of a third person in case of his default.—Sec. 126.

Example :

A lends Rs. 5000 to B and C promises to A that if B does not pay the money, C will do so. This is a contract of guarantee. B is called the *Principal Debtor*. A the *Creditor*, and C the *Guarantor* or the *Surety*.

A contract of guarantee may be either oral or written. A contract of guarantee (and also a contract of indemnity) must satisfy all the essential elements of a contract. (For example, the object must be lawful; there must be free consent etc.) But two points are to be noted :

² (1942) Bom 402, 670

³ 56 Cal 262

(i) In a contract of guarantee, the principal debtor may be a minor. In this case the surety is liable to pay even though the minor may not be. The contract will be enforced as between the surety and the creditor.

(ii) In a contract of guarantee, the consideration received by the principal debtor is taken to be sufficient consideration for the surety. "Anything done, or any promise made, for the benefit of the principal debtor may be sufficient consideration to the surety for giving the guarantee."—Sec. 127.

Examples :

- (i) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is a sufficient consideration for C's promise.
- (ii) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.
- (iii) A sells and delivers goods to B. C afterwards, without consideration agrees to pay for them in default of B. The agreement is void.

DIFFERENCES BETWEEN CONTRACTS OF INDEMNITY AND CONTRACTS OF GUARANTEE

1. In a contract of indemnity, there are two parties ; the indemnifier and the indemnity-holder. In a contract of guarantee there are three parties, the creditor, the principal debtor, and the surety.

2. In a contract of indemnity, the liability of the indemnifier is primary; in a contract of guarantee, the liability of the surety is secondary, *i.e.* the surety is liable only if the principal debtor fails to perform his obligations.

3. In a contract of guarantee there is an existing debt or duty, the performance of which is guaranteed by the surety. In a contract of indemnity, the liability of the indemnifier arises only on the happening of a contingency.

4. In a contract of guarantee, the surety after he discharges the debt owing to the creditor, can proceed against the principal debtor; in a contract of indemnity the loss falls on the indemnifier except in certain special cases.

CONTINUING GUARANTEE

A guarantee which extends to a series of transactions is called a

Continuing Guarantee. (Sec. 129). A guarantee covering a single transaction may be called a **Simple Guarantee**.

Examples :

- (i) A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of 5000 rupees, for the due collection and payment by C of those rents. This is a continuing guarantee.
- (ii) A guarantees payment to B, a tea-dealer, to the amount of £100, for any tea he may from time to time supply to C. B supplies C with tea to the value of £100, and C pays B for it. Afterwards B supplies C with tea to the value of £200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of £100.
- (iii) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

How a Continuing Guarantee is Revoked. A continuing guarantee is revoked under the following circumstances :

1. *By notice of revocation by the surety :* The notice operates to revoke the surety's liabilities as regards transactions entered into after the notice. He continues to be liable for transaction entered into prior to the notice.—Sec. 130.

2. *By the death of the surety :* "The death of the surety operates, in the absence of a contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transaction."—Sec. 131.

The estate of the surety is liable for all transactions entered into prior to the death of the surety unless there was a contract to the contrary. It is not necessary that the creditor must have notice of the death.

A continuing guarantee is *terminated* under the same circumstances under which a surety's liability is discharged. (See below.)

THE EXTENT OF THE LIABILITY OF THE SURETY

The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.—Sec. 128.

Example :

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

A creditor is not bound first to proceed against the principal debtor. He can sue the surety without suing the principal debtor or without making the principal debtor a co-defendant. When the principal debtor is a minor, the surety alone is liable to the creditor.

When is a surety discharged from liability ? The liability of a surety under a contract of guarantee comes to an end under any one of the following circumstances :

1. *Notice of revocation* : In the case of a continuing guarantee, a notice by the surety to the creditor stating that he will not be responsible, will revoke his liability as regards all future transactions. He will remain liable for all transactions entered into prior to the date of the notice.—Sec. 130.

2. *Death of Surety* : In the case of a continuing guarantee the death of a surety discharges him from all liabilities as regards transactions after his death unless there is a contract to the contrary.—Sec. 131.

3. *Variation of contract* : Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.—Sec. 133.

Illustrations :

- (a) A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdraft. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.
- (b) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.
- (c) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.
- (d) A gives to C a continuing guarantee to the extent of 3,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

- (e) C contracts to lend B 5,000 rupees on the 1st March. A guarantees repayment. C pays the 5,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied inasmuch as C might sue B for the money before the 1st of March.

4. *Release or discharge of principal debtor* : The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.—Sec. 134.

Illustrations :

- (a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.
- (b) A contracts with B to grow a crop of indigo on A's land and to deliver it to B at a fixed rate, and C guarantees A's performance of this contract. B diverts a stream of water which is necessary for irrigation of A's land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.
- (c) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.
- (d) Failure to sue the principal debtor until recovery is barred by Statute of Limitation does not operate as a discharge of the surety. *Mohant Sing v. U. Ba Yi*.*

5. *Arrangement with principal debtor* : A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.—Sec. 135.

But where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.—Sec. 136.

Illustration :

- C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety.—Sec. 137.

Illustration :

B owes to *C* a debt guaranteed by *A*. The debt becomes payable. *C* does not sue *B* for a year after the debt has become payable. *A* is not discharged from his suretyship.

Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.—Sec. 138.

6. *Act or omission impairing surety's eventual remedy :* If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.—Sec. 139.

Illustrations :

- (a) *B* contracts to build a ship for *C* for a given sum, to be paid by instalments as the work reaches certain stages. *A* becomes surety to *C* for *B*'s due performance of the contract. *C*, without the knowledge of *A*, prepays to *B* the last two instalments. *A* is discharged by this prepayment.
- (b) *C* lends money to *B* on the security of a joint and several promissory note made in *C*'s favour by *B*, and by *A* as surety for *B*, together with a bill of sale of *B*'s furniture, which gives power to *C* to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, *C* sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realised. *A* is discharged from liability on the note.
- (c) *A* puts *M* as apprentice to *B*, and gives a guarantee to *B*, for *M*'s fidelity. *B* promises on his part that he will, at least once a month, see *M* make up the cash. *B* omits to see this done as promised, and *M* embezzles. *A* is not liable to *B* on his guarantee.

7. *Loss of security :* If the creditor loses or parts with any security given to him by the principal debtor at the time the contract of guarantee was entered into, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security.—Sec. 141. [See illustration (a) and (b) below.]

The Rights of the Surety. A surety has the following rights :

1. Upon payment or performance of all that he is liable for,

he is invested with all the rights which the creditor had against the principal debtor.—Sec. 140.

2. A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into. Whether the surety knows of the existence of security or not is immaterial.—Sec. 141.

Illustrations :

- (a) C advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.
- (b) C, a creditor whose advance to B is secured by a decree receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.
- (c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

3. In every contract of guarantee there is implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.—Sec. 145.

Illustrations :

- (a) B is indebted to C, and A is surety for the debt. C demands payment from A; and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.
- (b) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A, and, on A's refusal to pay, sues him upon the bill. A not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.
- (c) A guarantees to C, to the extent of 2000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2000 rupees, but obtains from A payment of the sum of 2000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.
- (d) A surety settled with the creditor by paying a sum smaller than the amount guaranteed. Held, he can recover only what he paid. *Reed v. Norris*,^a

^a 2 Bing 361

Contracts of Guarantee which are Invalid. A contract of guarantee is invalid in the following cases :

1. Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.—Sec. 142.
2. Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.—Sec. 143.

Illustrations :

- (a) A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.
- (b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.
3. Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.—Sec. 144.
4. A contract of guarantee is invalid if it lacks one or more of the essential elements of a contract (e.g. if there is want of free consent or if the object is illegal).

CONTRIBUTION BETWEEN CO-SURETIES

Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.—Sec. 146.

Illustrations :

- (a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable as between themselves, to pay 1000 rupees each.
- (b) A, B and C are sureties to D for the sum of 1000 rupees lent to E and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees and C 500 rupees.

Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.—Sec. 147.

Illustrations :

- (a) A, B and C, as sureties for D enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.
- (b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees.
- (c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

EXERCISES

- (1.) Distinguish between a contract of Guarantee and a contract of Indemnity. Explain 'Continuing Guarantee' and show how it is terminated. (C.U., '51, '55, '57).
2. How does a Contract of Indemnity differ from a Contract of Guarantee? What rights, if any, has the surety got against (a) the Principal Debtor and (b) the Creditor? (C.U., B.Com. '62).
3. B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. Is A discharged from his suretyship? (C.U., '57).
4. Distinguish between indemnity and guarantee. Discuss if the surety is discharged in the following cases :
 - (a) The claim is barred against the debtor but not against the surety.
 - (b) A bank in whose favour a fidelity guarantee was given for the good conduct of an employee, excused the employee on one occasion when he misappropriated bank's moneys without informing the surety about it and the employee again misappropriates.
 - (c) C contracts to lend B Rs. 5000 on the 1st of March. A guarantees repayment. C pays Rs. 5000 on the 1st of January. (C.A., May '50).
5. Explain with reference to the provisions of the Indian Contract Act the rule that between co-sureties there is equality of the burden and benefit. (C.A., May '54).
6. What are the rights of a surety against the principal debtor and against the co-sureties? (C.A., Nov. '54).
7. What are the rights and liabilities of a surety? Give the various ways in which a surety is discharged from liability. (C.A., May '55).

CHAPTER 15

BAILMENT

(**Definition of Bailment.** “A bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.” —Sec. 148. ✓

The person delivering the goods is called the **Bailor**. The person to whom they are delivered is called the **Bailee**. The transaction is **Bailment**.)

Examples -

- (i) A lends his book to B.
 - (ii) A delivers a watch to B for repair.
 - (iii) A gives B his watch as security for a loan.
- In all these cases A is the bailor and B is the bailee.

From Section 148 it follows that a bailment has the following characteristic features :

- (i) It is delivery of *goods* by one person to another.
- (ii) The goods are delivered for some *purpose*.
- (iii) It is agreed that when the purpose is accomplished the goods are to be returned or otherwise disposed of according to the direction of the bailor.

A person already in possession of the goods may become a bailee by a subsequent agreement, express or implied.

Example :

X is a seller of motor cars, having several cars in his possession Y buys a car and leaves the car in the possession of X. After the sale is complete, X becomes a bailee, although originally he was the owner.

“The delivery of goods to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf.”—Sec. 149.

Bailment is concerned with only movable goods. Money is not included in the category of movable goods. A deposit of money is not bailment.

Different kinds of Bailment. Lord Holt in a leading English case (*Coggs v. Bernard*) classified bailment into six kinds as follows :

(i) *Deposit*—Delivery of goods by one man to another to be held for the bailor's use. Deposit for safe custody comes under this category.

(ii) *Commodatum*—Goods lent to a friend gratis to be used by him and returned.

(iii) *Hire*—Delivery of goods to the bailee for his use in return for a payment of money.

(iv) *Pawn*—Goods delivered to a creditor as security for a loan.

(v) *Carriage and Repair*—When goods are delivered for the purpose of carriage from one place to another or for repairs, in return for a money payment.

(vi) The above *without any remuneration*—gratuitous carriage or repairs.

Bailments may also be classified into :

1. **Gratuitous Bailments, and**

2. **Bailments for Reward.**

A gratuitous bailment is one in which neither the bailor, nor the bailee is entitled to any remuneration.

Examples :

Loan of an article *gratis*; safe custody without charge.

A bailment for reward is one where either the bailor or the bailee is entitled to a remuneration.

Examples :

A motor car let out for hire; goods given to a carrier for carriage at a price; articles given to a person for being repaired for a remuneration.

DUTIES OF THE BAILEE

*1. **Degree of Care.** The bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.—Sec. 151.) ✖

The degree of care to be taken by a bailee is that of a man of ordinary prudence. (If he takes that amount of care, he will not be held responsible for loss, destruction or deterioration of the goods bailed. (Sec. 152).) The degree of care required from the bailee is the same whether the bailment is for reward or is gratuitous.

(There may be a special contract between the bailor and the bailee

by which the bailee is required to take a higher degree of care or under which he is responsible for compensating in full for loss, destruction or deterioration of the goods. Such special terms are usually incorporated in contracts of carriage.)

2. Unauthorised use of goods. If the bailee makes unauthorised use of the goods bailed, *i.e.* uses them in a way not authorised by the terms of the bailment, he is responsible for all damages to the goods and must pay compensation to the bailor. This liability arises even if the bailee is not guilty of any negligence, and even if the damage is the result of accident.—Sec. 154.

Examples :

- (i) A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.
- (ii) A hires a horse in Calcutta from B expressly to march to Benares. A rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. A is liable to make compensation to B for the injury to the horse.

3. Mixture of bailor's goods with the bailee's. If the bailee mixes up his own goods with those of the bailor, the following rules apply :

Section 155. "If the bailee, with consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced."

Section 156. "If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damage arising from the mixture."

Example :

A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark. A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

Section 157. "If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods."

Example :

A bails a barrel of Cape flour worth Rs. 45 to B. B, without A's consent, mixes the flour with country flour of his own, worth only Rs. 25 a barrel. B must compensate A for the loss of his flour.

4. Duty of returning goods. "It is the duty of the bailee to return or deliver according to the bailor's directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished."—Sec. 160.

"If, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time."—Sec. 161.

5. Accretion to the goods bailed. "In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed."—Sec. 163.

Example :

A leaves a cow in the custody of B to be taken care of. The cow has a calf. B is bound to deliver the calf as well as the cow

DUTIES OF THE BAILOR

1. Bailor's duty to disclose faults in goods bailed. "The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks, and, if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed."—Sec. 150.

Examples :

- (i) A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.
- (ii) A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

2. Payment of expenses in Gratuitous Bailments : "Where by the conditions of the bailment, the bailee is to receive no remuneration,

the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.”—Sec. 158.

3. *Responsibility for breach of warranty of title* : The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give direction respecting them.—Sec. 164.

Example :

A gives B's car to C for use without B's knowledge or permission. B sues C and receives compensation. C is entitled to recover his losses from A.

BAILEE'S RIGHTS

1. The bailee can, by suit, enforce the duties of the bailor.

2. “If several joint owners of goods bail them, the bailee may deliver them back to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary.”—Sec. 165.

3. “If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to directions of the bailor, the bailee is not responsible to the owner in respect of such delivery.”—Sec. 166.

4. **Bailee's Lien.** “Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.”—Sec. 170.

Examples :

- (i) A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.
- (ii) A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months' credit for the price. B is not entitled to retain the coat until he is paid.

“Bankers, factors, wharfingers, attorney of a High Court and policy-brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account, any goods bailed to them; but no other persons have a right to retain as a security for such balance, goods bailed to them, unless there is an express contract to the effect.”—Sec. 171.

Bailee's lien. Lien means the right to retain property until some debt or claim is paid. The right of lien is given by law in certain cases. Lien may be of two types : General Lien and Particular Lien. General lien means the right to retain *all* the goods of the other party until *all* the claims of the holder are paid. Particular lien means the right to retain a particular goods until all claims on account of that particular goods are paid.

A bailee has a particular lien, when he has rendered any service upon an article and is entitled to some remuneration for it according to the terms of the contract between him and the other party. The following limitations upon the bailee's particular lien are to be noted :

(i) The particular lien is available only if the service rendered by the bailee is one involving the *exercise of labour or skill* in respect of the goods bailed. There is no lien for custody charges or other charges for work not involving labour or skill.

(ii) The right of lien cannot be exercised until the services have been performed in full. When a bailee has done only a part of the work contracted for he cannot claim lien for part payment.

(iii) The lien cannot be claimed if there is an agreement to pay the money on a future date.

(iv) The lien can be exercised only so long as the goods are in the possession of the bailee. If possession is lost for any reason, the lien is also lost.

Bailee's general lien.—Bailee's coming within the following categories have a general lien : bankers, factors, wharfingers, attorneys of High Court, and policy brokers. Such bailees can retain all goods of the bailor so long as anything is due to them. The general lien in all these cases may not exist if there is a contract to the contrary. Bailees falling in categories other than those mentioned above may have a general lien if there is an express agreement to that effect.

BAILOR'S RIGHTS

1. The bailor can enforce by suit all the liabilities or duties of the bailee.

2. "A contract of bailment is voidable, at the option of the bailor, if the bailee does any act with regard to the goods bailed inconsistent with the conditions of the bailment."—Sec. 153.

Example :

A lets to B, for hire, a horse for his own riding. B drives the horse

in his carriage. This is, at the option of A, a termination of the bailment.

3. When goods are lent gratuitously, the bailor can demand their return whenever he pleases, even though he lent it for a specified time or purpose. But if the bailee in such cases had acted in such a manner that the return of the goods before the stipulated time would cause loss greater than the benefit which he has received, the bailor must indemnify him for the loss if he compels an immediate return.—Sec. 159.

TERMINATION OF BAILMENT

A contract of bailment terminates under the following circumstances :

1. If the bailment is for a stipulated period, the bailment terminates as soon as the stipulated period expires.

2. If the bailment is for a specific purpose, the bailment terminates as soon as the purpose is fulfilled.

3. If the bailee does any act, with regard to the goods bailed, which is inconsistent with the terms of the bailment, the bailment terminates.—Sec. 153.

4. A gratuitous bailment can be terminated any time but if premature termination causes any loss to the bailee, the bailor must indemnify the bailee.—Sec. 159.

5. A gratuitous bailment terminates upon the death of either the bailor or the bailee.—Sec. 162.

RIGHTS OF FINDER OF GOODS

A finder of goods is in the position of a bailee if he takes charge of the goods. The rights of the finder of goods can be summarised as follows. (Sections 168 and 169):

1. He can retain possession of the goods against everybody except the true owner.

2. He is entitled to be compensated for the trouble and expense incurred by him to preserve the goods and to find out the owner. He has a lien upon the goods for the payment of these sums *i.e.* he can refuse to return the goods until they are paid.

3. He cannot file a suit for the expense he has incurred but can sue for any reward which the owner might have offered for the return of the goods lost.

4. If the goods found are commonly the subject-matter of sale and if the owner cannot with reasonable diligence be found or if he

refuses to pay the lawful charges of the finder, the goods can be sold provided the following further conditions are fulfilled—

- (a) When the thing is in danger of perishing or of losing the greater part of its value.
- (b) When the lawful charges of the finder amount to two-thirds of its value.

BAILMENT AND THIRD PARTIES

1. If a person, other than the bailor, claims the goods bailed, he may apply to the courts to stop delivery of the goods bailed and to decide the title to the goods.

2. If a third party wrongfully deprives the bailee of the use of the goods bailed or does them any injury, the bailee is entitled to use all such remedies as the owner of the goods might have used. Either the bailee or the bailor may file a suit against the third party in such cases.—Sec. 180.

3. Whatever is obtained by way of relief in such suits shall be divided between the bailor and the bailee according to their respective interests.—Sec. 181.

BAILMENTS BY WAY OF PLEDGE OR PAWN

The bailment of goods as security for payment of a debit or performance of a promise is called Pledge or Pawn. The bailor in this case is called the Pledgor or the Pawnor. The bailee is called the Pledgee, or the Pawnee.—Sec. 172.

When can a non-owner make a valid pledge? The owner of goods ~~can~~ always make a valid pledge. In the following cases, one who is not an owner can make a valid pledge.

1. A mercantile agent who is, with the consent of the owner, in possession of the goods or of the documents of title to goods, can make a valid pledge of the goods while acting in the ordinary course of business of a mercantile agent. Such a pledge will be valid even if the agent had no authority to pledge, provided that the pawnee acts in good faith and has not at the time of the pledge any notice that the pawnor has not authority to pledge.—Sec. 178.

2. A person having possession of goods under a voidable contract can make a valid pledge of the goods so long as the contract is not rescinded. The pawnee gets a good title to the goods provided

he acts in good faith and without notice of the pawnor's defect of title.—Sec. 178A.

Example :

A gets an ornament by inducing the owner to sell it to him by undue influence. Before the contract is rescinded by the owner, he pawns it to B. B will get a good title to the ornament provided he acted in good faith and was unaware of A's defective title.

(3) Where a person pledges goods in which he has only a limited interest the pledge is valid to the extent of that interest.—Sec. 179.

4. If one of several co-owners is in sole possession of the goods with the consent of the owners, he can make a valid pledge of the goods.

THE RIGHTS OF THE PLEDGEE OR PAWNEE

1. **Right of Retainer.** "The pawnee can retain the goods pledged not only for payment of the debt or the performance of the promise, but for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged."—Sec. 173.

2. The pawnee's lien is a particular lien i.e. he cannot retain the goods for any debt other than the debt for which the security was given unless there is an express contract to the contrary. If the pawnee makes fresh advances to the same debtor it will be presumed that the debtor has agreed to create on the goods already pledged a lien for the fresh advance.—Sec. 174.

3. The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.—Sec. 175.

Illustration: "If the pawnor makes a default in payment of the debt, or performance, at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as collateral security; or, he may sell the thing pledged on giving the pawnor reasonable notice of the sale.

If the proceeds of such sale are less than the amount due, in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor."—Sec. 176

THE RIGHTS OF THE PLEDGOR

1. "If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, in that case, pay, in addition, any expenses which have arisen from his default."—Sec. 177.

2. The pledgor can enforce the preservation and proper maintenance of the goods pledged.

3. The pledgor as a debtor has various rights given to him by statutes enacted for the protection of debtors, e.g. the Moneylenders Acts.

EXERCISES

1. What is a bailment? What kind of care is a bailee bound to take of goods bailed to him? (C.U. '50).

2. (a) What is a pledge? What are the rights of a pawnee?
(b) A lends his horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. What remedy has A against B? (C.U. '57).

3. Define Pledge. State the respective rights and duties of the Pawnor and Pawnee. (C.U. '52).

4. What is bailment? What is the 'standard of care' a bailee has to take in respect of goods bailed to him? What is a bailee's 'particular lien'? (C.U. '55).

5. State the rights of a bailor and bailee against third persons. (C.A., May '51).

6. Explain what relief is available to the bailor in case of mixture of bailor's goods with the bailee's. (C.A., Nov. '52).

CHAPTER 16

AGENCY

Definition and Nature of Agency. “An ‘Agent’ is a person employed, to do any act for another or to represent another in dealings with third persons.”—Sec. 182.

The person for whom such act is done or who is so represented, is called the “Principal”. The transaction is called Agency. *A* appoints *X* to buy 50 bales of cotton on his behalf. *A* is the principal and *X* is his agent.

The function of an agent is to bring about contractual relations between the principal and third parties. Usually agents are appointed with specific instructions and authorised to act within the scope of their instructions. Acts of the agent within the scope of the instructions bind the principal as if he has done them himself. There is a legal maxim regarding agency viz. “*Qui facit per alium facit per se*”, which means—“He who does through another does by himself”. The act of an agent is the act of the principal.

“Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner and will have the same legal consequences, as if the contracts had been entered into and the acts done by the principal in person.”—Sec. 226.

Illustrations :

- (a) *A* buys goods from *B*, knowing that he is an agent for their sale, but not knowing who is the principal. *B*'s principal is the person entitled to claim from *A* the price of the goods, and *A* cannot, in a suit by the principal, set off against that claim a debt due to himself from *B*.
- (b) *A*, being *B*'s agent with authority to receive money on his behalf, receives from *C* a sum of money due to *B*. *C* is discharged of his obligation to pay the sum in question to *B*.

The Test of Agency. Agency exists whenever a person can bind another by acts done on his behalf. When this power does not exist the relationship is not one of agency. Thus a wife is not the agent of the husband except under special circumstances and for special purposes. But, the constituted attorney of a person is his agent for the purposes mentioned in the power of attorney.

Difference between an Agent and a Servant. A servant has to act according to the orders of the master in every particular; an agent is appointed to bring the principal into contractual relations with third parties. A servant cannot bind the principal to third parties; an agent can bind the principal to third parties. A servant can, however, be appointed an agent for some purpose.

Difference between an Agent and an Independent Contractor. A person who undertakes to do something for another is called an independent contractor, if the manner of doing the thing is left to him. An independent contractor does not represent the other contracting party nor can he bind him by contracts entered into with others. An agent is one who acts according to the instructions of the principal and can bind the principal by entering into contracts with other persons within the scope of his authority.

Consideration in Agency Contracts. No consideration is necessary to create an agency (Sec. 185). The acceptance of the office of an agent is regarded as sufficient consideration for the appointment. The agency contract generally provides for the amount of remuneration payable by the principal to the agent.

Specific Performance of a Contract of Agency. An agreement to appoint an agent or to serve as an agent cannot be specifically enforced. But the aggrieved party can get damages for breach of contract, if there is any.

DIFFERENT KINDS OF AGENTS

The relationship between the principal and agent and the extent of the authority of the latter are matters to be determined by agreement of the parties.

There are, however, certain well-known varieties of agency-contracts where the powers and duties of the agent are settled by usage and custom of trade recognised by the courts of law. Some of these particular kinds of agency-contracts, together with their legal incidents are described below.

1. **Broker.** A broker is one who brings buyers and sellers into contact with one another. His duties are at an end when the parties are brought together. The contract of sale and purchase is entered into directly by the parties. The broker does not keep the goods or the property of the principal in his possession.

2. **Factor.** A factor is a mercantile agent with whom goods are kept for sale. He has got discretionary powers to enter into contracts

of sale with third parties. He has a general lien on the goods for moneys due to him as agent.

3. A Commission Agent. A commission agent is one who secures buyers for a seller of goods and sellers for a buyer of goods in return for a commission on the sale. A commission agent may have possession of the goods or not. His position is very similar to that of a broker.

4. Auctioneer. An auctioneer is one who is authorised to sell goods of his principal by auction. He has a particular lien on the goods for his remuneration. He has the goods in his possession and can sue the buyer in his own name for the purchase price. An auctioneer acts in a double capacity. Up to the moment of sale he is the agent of the seller. After the sale he is the agent of the buyer. An auctioneer has implied authority to sell the goods without any restriction. Therefore a sale by him in violation of instructions is binding on the owner. If the owner directs the auctioneer not to sell below a reserve price and the auctioneer sells it below the price the sale is binding on the owner except in cases where the buyer knew that there was a limitation on the auctioneer's authority.

5. A Del Credere Agent. A *del credere* agent is one who, for an extra remuneration, guarantees the performance of the contract by the other party. If the other party fails to pay the price or otherwise causes damage to the principal, the *del credere* agent must pay compensation to the principal.

6. General Agent and Particular Agent. A general agent is one who represents the principal in all matters concerning a particular business. A particular agent is one who is appointed for a specific purpose *e.g.* to sell a particular article. Factors and commission agents are usually general agents. When general agents are appointed it is usual to execute a general power of attorney by which the agent is given authority to do certain things. A particular agent may be appointed by executing a special power of attorney by which the agent is authorised to do a specific thing. A power of attorney must be written and stamped.

A man dealing with a particular agent, *e.g.*, one holding a special power of attorney, is bound to find out the limits of the authority of the agent and act accordingly.

METHODS OF CREATING AGENCY

Agency may be created in any one of the following ways :

1. Agency by Express Agreement. A contract of agency may be

created by express agreement. The agreement may be either oral or written. It is usual in many cases to appoint agents by executing a formal power of attorney on a written and stamped document.

2. **Agency by Implied Agreement.** An agency agreement may be implied under certain circumstances from the conduct of the parties or the relationship between them. Agency by estoppel and agency of necessity are cases of implied agency.

3. **Agency by Estoppel or by Holding Out.** Agency may be created by estoppel. When a man has by his conduct or statements induced others to believe that a certain person is his agent, he is precluded from subsequently denying it. Thus an agency is created by implication of law.

Examples :

- (i) A allows his servant X to buy goods for him on credit regularly. On one occasion the servant buys some goods not ordered by his master, on credit. A is responsible to the shopkeeper for the price because X will be deemed to be his agent by estoppel.
- (ii) A employed X a broker, to buy hemp for him and at A's request it was kept in a warehouse in X's name. X without A's authority sold the hemp. Held, A was bound by the sale because he had allowed X to assume the apparent right of disposing of the hemp in the ordinary course of business. *Pickering v. Busk*.¹

There are three possible cases of agency by estoppel :

(a) A person can be held out as an agent although he is actually not so—*Example (i)* above.

(b) A person acting as agent may be held out as having more authority than he actually has—*Example (ii)* above.

(c) A person may be held out as agent after he has ceased to be so.

Section 237 provides as follows : "When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts or obligations were within the scope of the agent's authority."

Illustrations :

- (a) A consigns goods to B for sale and gives him instructions not to sell under a fixed price. C, being ignorant of B's instruc-

¹ (1812) 15 East 38

- in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.
- (ii) A holds a lease from B, terminable on three months' notice. C, an unauthorised person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

Who can appoint an agent ?

"Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent."—Sec. 183.

Who may be agent ?

Any person may be an agent, even a minor. A minor acting as agent can bind the principal to third parties. But a minor is not himself liable to his principal.—Sec. 184.

Extent of the agent's authority.

"The authority of an agent may be expressed or implied."—Sec. 186.

The authority is said to be express when it is given by words spoken or written. The authority is said to be implied when it is to be inferred from the circumstances of the case. The inference, as to implied authority, may be drawn from things spoken or written, or the ordinary course of dealing between the parties and others—Sec. 187.

Example :

A owns a shop in Serampur, living himself in Calcutta, and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

"An agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act.

An agent having an authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business."—Sec. 188.

Illustrations :

- (a) A is employed by B, residing in London, to recover at Bombay a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt, and may give a valid discharge for the same.
- (b) A constitutes B his agent to carry on his business of a ship-builder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on the business.

“An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.”—189.

Illustrations :

- (a) An agent for sale may have goods repaired if it be necessary.
- (b) A consigns provisions to B at Calcutta, with directions to send them immediately to C at Cuttack. B may sell the provisions at Calcutta, if they will not bear the journey to Cuttack without spoiling.

Effects of notice to agent or information obtained by agent.

Any notice given to or information obtained by the agent (provided it be given or obtained in the course of the business transacted by him for the principal) shall have the same legal consequences as if it had been given to or obtained by the principal.—Sec. 229.

Illustrations :

- (a) A is employed by B to buy from C certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set-off a debt owing to him from C against the price of the goods.
- (b) A is employed by B to buy from C goods of which C is the apparent owner. A was before he was so employed, a servant of C, and then learnt that the goods really belonged to D, but B is ignorant of that fact. In spite of the knowledge of his agent, B may set-off against the price of the goods a debt owing to him from C.

What happens when the agent exceeds his authority ?

“When, an agent does more than he is authorized to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority, is binding as between him and his principal.”—Sec. 227.

Illustration :

A, being owner of a ship and cargo, authorizes B to procure an insurance for 4,000 rupees on the ship. B procures a policy for 4,000 rupees on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

“Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction.”—Sec. 228.

Illustration :

A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of 6,000 rupees. A may repudiate the whole transaction.

The principal may be bound by unauthorised acts of the agent in two cases: (i) Where by the principle of estoppel the principal is precluded from denying the authority of the agent. (See cases cited under "Agency by Estoppel".) (ii) Where an agency has been terminated but notice of termination has not been received by the other parties concerned. (See below.)

SUB-AGENT AND CO-AGENT

The general rule is that an agent cannot appoint an agent. ("*Delegatus non potest delegare.*") "An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally." (Sec. 190). But there are two exceptions to this rule. An agent can appoint an agent (i) when it is permitted by the custom of the trade with which the agency is concerned ; and (ii) when it is necessary because of the nature of the agency.

Sub-agent. An agent appointed by an agent is called a Sub-agent. "A sub-agent is a person employed by, and acting under the control of, the original agent in the business of the agency." (Sec. 191). The consequences of the appointment of a sub-agent are stated below :

1. A sub-agent is appointed by and acts under the control of the original agent.—Sec. 191.

2. The principal is represented by the sub-agent and is bound by and responsible for his acts as if he were an agent appointed by the principal.—Sec. 192.

3. The agent is responsible to the principal for the acts of the sub-agent.—Sec. 192.

4. The sub-agent is responsible for his acts to the agent. The sub-agent is not responsible to the principal except in case of fraud and wilful wrong.—Sec. 192.

5. Where an agent improperly appoints a sub-agent, the agent is responsible for his acts both to the principal and to third parties. The principal in such cases is not represented by the sub-agent nor is he responsible for the acts of the sub-agent—Sec. 193.

Co-agent. A co-agent is a person appointed by the agent according to the express or implied authority of the principal, to act *on behalf of the principal* in the business of the agency. (Sec. 194). Such

a person is an agent of the principal and is responsible to him. A co-agent is sometimes called a Substituted Agent.

In case of a co-agent there is direct privity of contract between the principal and the co-agent. There is no direct privity of contract between the principal and the sub-agent, except in cases of fraud and wilful wrong-doing.

Examples :

- (i) A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub-agent, but is A's agent for the conduct of the sale.
- (ii) A authorizes B, a merchant in Calcutta, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co., for the recovery of the money. D is not a sub-agent but is solicitor for A.

An agent in appointing a co-agent must exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case. If he does this he is not responsible to the principal for acts of negligence of the co-agent.—Sec. 195.

Examples :

- (i) A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.
- (ii) A consigns goods to B, a merchant, for sale. B, in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

TERMINATION OF AGENCY

An agency may be terminated by *act of parties* or by *operation of law*. The different possible circumstances leading to the termination of agency are enumerated below—Sections 201-210.

I. Termination by act of parties

The principal may, by notice, revoke the authority of the agent. The agent may similarly, by notice, renounce the business of agency.

Where there is an express or implied agreement to continue the agency for any length of time; and the contract of agency is revoked or renounced without sufficient cause, compensation must be paid to the injured party.—Sec. 205.

The principal cannot revoke the authority of the agent in the following cases :

Illustrations :

- (a) *B*, at Singapore, under instructions from *A* of Calcutta, contracts with *C* to deliver certain goods to him. *A* does not send the goods to *B*, and *C* sues *B* for breach of contract. *B* informs *A* of the suit, and *A* authorizes him to defend the suit. *B* defends the suit, and is compelled to pay damages and costs, and incurs expenses. *A* is liable to *B* for such damages, costs and expenses.
 - (b) *B*, a broker at Calcutta, by the orders of *A*, a merchant there, contracts with *C* for the purchase of 10 casks of oil for *A*. Afterwards *A* refuses to receive the oil, and *C* sues *B*. *B* informs *A*, who repudiates the contract altogether. *B*, defends, but unsuccessfully, and has to pay damages and costs and expenses. *A* is liable to *B* for such damages, costs and expenses.
2. Where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the rights of third persons.—Sec. 223.

Illustrations :

- (a) *A*, a decree-holder and entitled to execution of *B*'s goods, requires the officer of the Court to seize certain goods, representing them to be the goods of *B*. The officer seizes the goods and is sued by *C*, the true owner of the goods. *A* is liable to indemnify the officer for the sum which he is compelled to pay to *C*, in consequence of obeying *A*'s directions.
 - (b) *B*, at the request of *A*, sells goods in the possession of *A*, but which *A* had no right to dispose of. *B* does not know this and hands over the proceeds of the sale to *A*. Afterwards *C*, the true owner of the goods, sues *B* and recovers the value of the goods and costs. *A* is liable to indemnify *B* for what he has been compelled to pay to *C* and for *B*'s own expenses.
- But where one person employs another to do an act which is *criminal*, the employer is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that act.—Sec. 224.

Illustrations :

- (a) *A* employs *B* to beat *C*, and agrees to indemnify him against all consequences of the act. *B* thereupon beats *C*, and has to pay damages to *C* for so doing. *A* is not liable to indemnify *B* for those damages.
 - (b) *B*, the proprietor of a newspaper, publishes, at *A*'s request, a libel upon *C* in the paper, and *A* agrees to indemnify *B* against the consequences of the publication, and all costs and damages of any action in respect thereof. *B* is sued by *C* and has to pay damages, and also incurs expenses. *A* is not liable to *B* upon the indemnity.
3. The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.—Sec. 225.

Illustration :

A employs B as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskilfully put up, and B is in consequence hurt. A must make compensation to B.

PRINCIPAL'S RIGHTS

The principal is entitled to compensation for any breach of duty by the agent. The agent's duties are the principal's rights. The principal can revoke the agent's authority, subject to certain conditions.

AGENTS RIGHTS

1. The agent can enforce all the duties of the principal. The principal's duties are the agent's rights.

2. **Agent's Right of Retainer.** An agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent.—Sec. 217.

3. **Right to receive Remuneration.** In the absence of any special contract, the agent's remuneration does not become due until he has completed the act for which he was appointed agent. But an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.—Sec. 219.

An agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business which he has misconducted.—Sec. 220.

Examples :

- (i) A employs B to recover Rs. 100,000 and to lay it out on good security. B recovers Rs. 100,000 and lays out Rs. 90,000 on good security but lays out Rs. 10,000 on bad security whereby A loses Rs. 2000. B is entitled to remuneration for recovering Rs. 100,000 and for investing Rs. 90,000. He is not entitled to any remuneration for investing Rs. 10,000 and must make good the loss of Rs. 2000 to A.
- (ii) A employs B to recover Rs. 1000 from C. Through B's misconduct the money is not recovered. B is entitled to no remuneration for his services, and must make good the loss.

4. **Agent's Lien.** In the absence of any contract to the contrary, an agent is entitled to retain goods, papers and other property, whether movable or immovable of the principal, received by him, until the

amount due to himself for commission, disbursements, and services in respect of the same has been paid or accounted for to him.—Sec. 221.

WHEN AN AGENT IS PERSONALLY RESPONSIBLE TO THIRD PARTIES

It is provided by Section 230 that, in the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them.

But if there is an agreement to that effect, express or implied, the agent may enforce the contract and may also be personally liable on it. Such a contract shall be presumed to exist in the following cases :

- (1) where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;
- (2) where the agent does not disclose the name of his principal;
- (3) where the principal, though disclosed, cannot be sued (for example, if he is a foreign sovereign).

In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them liable.—Sec. 233.

Illustration :

A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

✓ CONTRACTS WITH AN UNDISCLOSED PRINCIPAL

An agent may enter into a contract with a person without disclosing the name of the principal. The legal consequences of contracts with undisclosed principals are as follows :

1. If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract. But the other contracting party has, as against the principal, the same right as he would have had as against the agent if the agent had been principal.—Sec. 231 (para 1).

2. If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract,

if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract.—Sec. 231 (para 2).

3. Where one man makes a contract with another, neither knowing nor having reasonable ground to suspect that the other is an agent, the principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.—Sec. 232.

Illustration :

A, who owes Rs 500 to B, sells Rs. 1000 worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

4. In contracts with an undisclosed principal, the agent is, in the absence of a contract to the contrary, personally liable on the contract. The other party may hold either the agent or the principal or both liable.—Sec. 233.

PRETENDED AGENTS

A person untruly representing himself to be the authorized agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employer does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing.—Sec. 235.

A pretended agent has no authority to act as agent. When the other party to the contract suffers damage as a result of such want of authority, he can sue the agent for breach of warranty of authority. The pretended agent is liable to pay damages under the Law of Torts. The liability arises even when the agent acted innocently.

Example :

A firm of solicitors were instructed by a client to defend a suit. Subsequently the client became insane (and the solicitors' authority as agents terminated by law). The solicitors in ignorance of the fact took steps to defend the suit. Held, the solicitors were personally liable for the costs of the other side, as on a breach of warranty of authority. *Young v. Toynbee*.⁵

A person with whom a contract has been entered into in the character of agent, is not entitled to require the performance of it

if he was in reality acting, not as agent, but on his own account.—Secs 236.

MISREPRESENTATION AND FRAUD BY AGENTS

Misrepresentations made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made or committed by the principals.

But misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.—Sec. 238.

Examples :

- (i) A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.
- (ii) A the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended consignor.
- (iii) A solicitor's managing clerk had authority to transact conveyancing business on behalf of his employer. He induced an old lady client to sign a conveyance of her properties to himself. With the help of the document the clerk sold the properties to another and decamped with the proceeds. Held that as the clerk was acting in course of the business of the solicitor, the solicitor must make good the loss of the old lady. *Lloyd v. Grace Smith & Co.**

REPRESENTATION AS TO LIABILITY

When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, he cannot subsequently hold the agent liable on the contract. Similarly if a person induces the principal to act on the belief that the agent only will be held liable, he cannot afterwards hold the principal liable on the contract.—Sec. 234.

EXERCISES

1. Z, the wife of X, pledges with A the furniture and the books in the library belonging to her husband for the prices of (a) jewellery, (b) food necessary for her maintenance without X's knowledge and consent. What are rights of A? (C U. '46).

✓ 2. What are the duties of an agent to his principal? A, a merchant in England, directs B, his agent at Bombay, to send him 100 bales

of cotton by a certain ship. *B* having it in his power to send the cotton omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. What is the extent of *B*'s liability to *A*? (C.U. '50).

✓3. What are the duties of a principal to his agent under the Indian Contract Act? (C.U. '51).

✓4. State the general rule with the main exceptions, as to the personal liability of an agent on contracts entered into by him on behalf of principals, Indian or foreign. (C.U. '54).

✓5. What is the effect of agency on contracts with third parties? When is a principal bound by unauthorised acts of his agent? (C.U. '56).

6. What is ratification? State the conditions that must be fulfilled before that doctrine can apply to the acts of an agent. (C.A., Nov. '51).

*7. What are the rights and liabilities of the parties in case of contracts through agents, when the principal is undisclosed? (C.U. '59).

✓8. What is the extent of the liability of the principal when his agent exceeds his authority? (C.A., Nov. '51).

✓9. State the different modes in which agency may be created. (C.A., Nov. '51).

10. Examine the position of a sub-agent *vis-à-vis* the agent and the principal. Explain the meaning of (i) agency of necessity (ii) agency by estoppel (iii) agency by ratification. Illustrate your answer. (C.A., May '52).

11. State the distinction between a sub-agent and a substituted agent. Discuss the rights and liabilities flowing from such appointment. (C.A., Nov. '53).

12. Discuss what is meant by "*Delegatus non potest delegare*" and enumerate the exceptions, if any, to the rule. (C.A., Nov. '53).

✓13. Discuss the liability of the principal for frauds of the agent (C.A., May '53).

✓14. What are the rights and duties of an agent? (C.A., Nov. '54).

15. When is agent personally liable for contracts brought about by him? (C.A., Nov. '55).

✓16. State the respective rights and duties of a Principal and an Agent, when the Principal is undisclosed. (C.U. '60).

✓17. Explain the instances when an agent can be made personally liable in respect of contracts entered into by him on behalf of the principal. (C.A., Nov. '58).

BOOK III
THE LAW RELATING TO SALE OF GOODS

CHAPTER I

DEFINITIONS

The law relating to the sale of movable goods is contained in the Indian Sale of Goods Act (Act III of 1930). The Act came into force on 1st July 1930. It closely follows the English act on the subject.

Meaning of Goods. The term "Goods" includes every kind of movable property except (i) actionable claims and (ii) money.

An actionable claim means a debt or a claim for money which a person may have against another and which he may recover by suit. Money means legal tender money. These two types of movable property are not included in the definition of the term goods as used in the Sale of Goods Act. All other types of movable property are "goods" under the Act.

Movable articles like furniture, clothing etc., and shares and debentures are goods. Things attached to the earth are not movable. But growing crops and grass, which can be easily separated from the earth before sale, and fruits which can be severed from trees, are included within the definition of movable goods.

Goods may be classified into three types : Existing Goods, Future Goods and Contingent Goods.

Existing Goods. Existing goods are goods which are already in existence and which are physically present in some person's possession and ownership.

Existing goods may be either (i) **Specific and Ascertained** or (ii) **Generic and Unascertained**. Specific Goods are goods which can be clearly identified and recognised as separate things *e.g.* a particular picture by a painter; a ring with distinctive features; goods identified and agreed upon at the time of the contract of sale etc. The term Ascertained Goods is used in the same sense as Specific Goods.

Generic Goods or Unascertained Goods are goods indicated by description and not separately identified. If a merchant agrees to

supply one bag of wheat from his godown to a buyer, it is a sale of unascertained goods because it is not known which bag will be delivered. As soon as a particular bag is separated out and marked or identified for delivery it becomes specific goods.

Future Goods. Future Goods are goods which will be manufactured or produced or acquired by the seller after the making of the contract of sale.

Example :

P agrees to sell to Q all the mangoes which will be produced in his garden next year. This is an agreement for the sale of future goods.

Contingent Goods. There may be a contract for the sale of goods the acquisition of which by the seller depends upon a contingency which may or may not happen. [Sec. 6(2)]. In such cases the goods sold are called Contingent Goods. Contingent goods come within the class of future goods.

Example :

X agrees to sell to Y a certain ring provided he is able to purchase it from its present owner. This is an agreement for the sale of contingent goods.

Sale and an Agreement to Sell. (Sec. 4). A contract for the sale of goods may be either a sale or an agreement to sell. Where under a contract of sale the property in the goods (*i.e.* the ownership) is transferred from the seller to the buyer, the contract is called a sale. The transaction is a sale even though the price is payable at a later date or delivery is to be given in the future, provided the ownership of the goods is transferred from the seller to the buyer.

Where the transfer of ownership is to take place at a future time or subject to some condition to be fulfilled later, the contract is called an agreement to sell.

Examples :

- (i) A agrees to buy from B a haystack on B's land, with liberty to come on B's land to take it away. This is a sale because the property in the goods has passed to buyer.
- (ii) P agrees to buy a quantity of soda to arrive by a certain ship. This is an agreement to sell because the property in the goods will pass to the buyer when the goods come and the agreement is naturally subject to the condition that the ship arrives in port with the goods.

An agreement to sell becomes a sale when the prescribed time elapses or the conditions, subject to which the property in the goods is to be transferred, are fulfilled.

Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods.

Differences between a Sale and an Agreement to Sell :

(i) In an agreement to sell, the property in the goods remains with the seller until the agreement to sell becomes a sale by the expiry of the agreed time or the fulfilment of the agreed conditions. Till this happens the goods can be resold by the seller or attached in execution of a decree against him. In case of a sale the property passes to the buyer and the goods cannot be seized in execution of a decree against the seller.

(ii) Where the transaction amounts to a sale, the goods belong to the buyer and he has to bear the loss if the goods are subsequently damaged or destroyed. (Sec. 26).

(iii) In the case of a sale, the unpaid seller has certain reliefs available, e.g. lien, stoppage in transit and resale. In case of an agreement to sell, the seller's remedy for breach of contract by the buyer is a suit for damages.

THE ESSENTIAL ELEMENTS OF A CONTRACT
FOR THE SALE OF GOODS

The essential elements of a contract for the sale of goods are enumerated below.

1. There must be a contract for the exchange of movable goods for money. An exchange of goods for goods is not a sale. But it has been held that if an exchange is made partly for goods and partly for money, the contract is one of sale. *Aldridge v. Johnson*.¹

2. Since a contract of sale involves a change of ownership, it follows that the buyer and the seller must be different persons. A man cannot buy from or sell to himself. To this rule there is one exception provided for in Section 4(1) of the Sale of Goods Act. A *part-owner* can sell to another *part-owner*.

Example :

P & Q are each of them $\frac{1}{4}$ owners of a certain stock of movable goods. P can sell his rights to Q. After the sale Q becomes owner of $\frac{1}{2}$ share.

3. A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery and payment by instalments, or that the delivery or payment or both shall be postponed.—Sec. 5(1).

¹ (1857) 7 E & B 885

4. Subject to the provisions of any law for the time being in force, a contract of sale may be in writing, or by word of mouth, or may be implied from the conduct of the parties.—Sec. 5(2).

(In England it is provided by statute that a contract for the sale of goods of the value of £ 10 or over is not enforceable unless it is evidenced by writing.)

5. The parties may agree upon any term concerning the time, place, and mode of delivery. The terms may be of two types : essential and non-essential. Essential terms are called Conditions, non-essential terms are called Warranties. The Sale of Goods Act provides that in the absence of a contract to the contrary, certain conditions and warranties are to be implied in all contracts of sale.

6. **The Price.** Price means the money consideration for the sale of goods. The price in a contract of sale may be fixed by the contract of sale or may be left to be fixed in a manner agreed between the parties. It may also be determined by the course of dealing between the parties. Where there is no provision made in the contract regarding price, the buyer must pay a reasonable price. What is reasonable is a question of fact depending upon the circumstances of the case.—Sec. 9.

Goods may be sold on a condition that the valuation is to be made by a third party. In such cases if the third party cannot or does not make the valuation, the agreement to sell becomes void. But if the goods or any part thereof had been delivered to and appropriated by the buyer, he shall pay a reasonable price therefor.

Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault is entitled to damages.—Sec. 10.

7. A contract for the sale of specific goods becomes void if the goods without the knowledge of the seller, have perished at the time when the contract was entered into or have become so damaged as no longer to answer to their description in the contract.—Sec. 7.

The same rule applies if the goods perish, or are damaged *after* agreement to sell but *before* sale. But in this case, the agreement is not avoided if there is any fault on the part of either the buyer or the seller or if the risk had passed to the buyer. (Sec. 8). The risk (of loss or damage to goods) passes to the buyer at the time agreed upon between the parties or when the ownership passes to the buyer.

8. A contract for the sale of goods must satisfy all the essential elements necessary for the formation of a valid contract *e.g.* the parties

must be competent to contract, there must be free consent, there must be consideration, the object must be lawful etc.

EARNEST MONEY

The payment of earnest money to mark the formation of an agreement for sale is a long standing custom in England as well as in India. There is usually an understanding that if the contract is broken by the buyer, the seller is to retain the earnest money as compensation; whereas if the contract is fulfilled the amount is credited to the purchase price payable. Earnest money is security for the fulfilment of an agreement. A provision for the forfeiture of earnest money is not considered to be a penalty clause.

✓SALE OF GOODS AND HIRE-PURCHASE AGREEMENTS

A hire-purchase agreement is one under which a person takes delivery of goods promising to pay the price by a certain number of instalments and, until full payment is made, to pay hire charges for using the goods.

A hire-purchase agreement usually has the following features :

1. A person takes delivery of goods promising to pay the price by an agreed number of instalments. Upon failure of payment of any instalment, the seller has the right of taking away the goods.
2. So long as the full price is not paid, the purchaser pays to the seller an agreed amount monthly or weekly as hire charges for the goods.
3. Upon payment of the price in full the sale is complete and the ownership of the goods passes from the seller to the buyer.
4. The purchaser has the option of paying the full price earlier, in which case the sale becomes completed earlier. The purchaser has also the option of terminating the agreement by returning the goods earlier, in which case he is not liable for the full price but only for hire charges for the period he had the goods with him plus the instalments which became due during that period.

In view of the aforesaid characteristics it can be said that a hire-purchase agreement is a *bailment plus an agreement to sell*. It is not a sale because in the case of a sale of specific goods, the property in the goods is transferred immediately to the buyer.

Hire-purchase agreements are frequently worded ambiguously and it is often difficult to determine whether a particular transaction is a

sale or a hire-purchase agreement.¹ The distinction is important because of the following reason. In a sale, the property is transferred to the buyer; he can deal with the property as he likes and the transferee of the purchaser gets a good title even if the price is unpaid. But in a hire-purchase agreement, the purchaser does not become owner till the full price is paid and therefore, the transferee from a person who has not paid the full price, gets no title.

The terms of the agreement have to be examined carefully in order to find out whether a transaction is a sale or merely a hire-purchase agreement. In a Bombay case it has been laid down that (i) if the purchaser has no option of terminating the agreement by returning the goods, the transaction is a sale and not a hire-purchase agreement and (ii) the transaction is a hire-purchase agreement only if the buyer has the option of returning the goods. *Bhimji v. Bombay Trust Corporation*.²

SALE OF GOODS AND A CONTRACT FOR WORK AND LABOUR

A contract of sale may be distinguished from a contract for work and labour. A contract of sale of goods contemplates the delivery of movable goods; but if in substance the contract is one for the exercise of skill, it is a contract for work and labour.

Examples :

- (i) A dentist agreed to make a set of artificial teeth to fit the mouth of a customer. Held, it is a contract for the sale of goods. *Lee v. Griffin*.³
- (ii) G engaged an artist to paint a portrait and supplied the canvas and paint. Held it is a contract for work and labour and not one for the sale of goods. *Robinson v. Graves*.⁴

The distinction between the two types of contracts is of importance in England but not in India. The reason is that in England contracts for the sale of goods must be in writing if the value of the goods is £10 or more, whereas contracts for work and labour may be oral. In India no writing is necessary in either case.

EXERCISES

1. Explain the nature of hire-purchase agreements. (C.A., Nov. '51).
2. Write notes on—Specific Goods; Unascertained Goods.
3. How would you distinguish between a contract of 'Hire-Purchase' and one of 'Instalment Sale'? (C.U. '61).

¹32 Bom. L.R. 64

²(1861) 30 L.J.K.B. 252

⁴(1935) 1 K.B. 579

CHAPTER 2

CONDITIONS AND WARRANTIES IN A CONTRACT OF SALE

Conditions and Warranties.¹ Section 12 of the Sale of Goods Act defines conditions and warranties as follows :

1. A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

2. A condition is a stipulation essential to the main purpose of contract, the breach of which gives rise to a right to treat the contract as repudiated.

3. A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated.

4. Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.

It is for the court to find out whether a particular term was intended by the parties to be a condition or whether it was intended to be a warranty only. The intention of the parties is always to be given effect to.

Section 11 of the Act lays down that stipulations as to time of payment are not to be deemed to be conditions unless such an intention appears from the terms of the contract.

Conditions and Warranties may be expressly stated in a written document or may be implied from the circumstances under which the contract was entered into.

When a condition can be treated as a warranty. (Sec. 13). Where a contract of sale is subject to a condition to be fulfilled by the seller, the buyer may waive the condition.

Example :

Certain goods were promised to be delivered on 1st June, time being made the essence of the contract. The goods were delivered on the 2nd June. The buyer *may* accept the goods.

¹ See Book II, Ch. 7, pp. 45-46.

The buyer may also elect to treat a breach of condition as a breach of warranty, *i.e.* instead of repudiating the contract he may accept performance and sue for damages, if he has suffered any.

Where a contract of sale is not severable and the buyer has accepted the goods or a part thereof, he cannot repudiate the contract but can only sue for damages. In such a case, the breach of condition can only be treated as a breach of warranty, unless there is a contract to the contrary.

In a contract for the sale of specific goods, if the property in the goods has passed to the buyer, a breach of condition by the seller can be treated only as a breach of warranty. The buyer cannot reject the goods or repudiate the contract but can only sue for damages, unless there is a contract to the contrary.

IMPLIED CONDITIONS AND WARRANTIES

Sections 14-17 of the Sale of Goods Act contain a list of conditions and warranties which are implied in a contract for the sale of goods, unless the circumstances of the contract are such as to show a different intention. The implied conditions and warranties are stated below.

IMPLIED CONDITIONS IN A CONTRACT OF SALE OF GOODS

1. **Condition as to Title.** There is an implied condition on the part of the seller that, in the case of a sale he has the right to sell the goods, and in the case of an agreement to sell, he will have the right to sell the goods at the time when the property is to pass.—Sec. 14(a).

Examples :

- (i) R bought a motor car from D and used it for four months. D had no title to the car and R was forced to return the car to the true owner. Here there is a breach of the implied condition as to title and R was held entitled to get back the purchase money paid notwithstanding the fact that he had used the car for 4 months. *Rowland v. Divall*.²
- (ii) If the goods delivered can be sold only by infringing a trade mark, the implied condition of title is violated and the buyer can recover damages. *Niblett Ltd. v. Confectioner's Materials Co.*³
- (iii) In a contract for the sale of shares there is an implied condition that there is no encumbrance or charge on the shares in favour of a third party. *Kissenchand v. Ramprotap*.⁴

² (1923) 2 K.B. 500

³ (1921) 3 K.B. 387

⁴ 44 C.W.N. 505

2. Sales by description. Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description.—Sec. 15.

Goods are said to be sold by description when the contract contains a description of the goods to be supplied. Such description may be in terms of the physical characteristics of the goods or may simply mention the trade mark, trade name, brand, or label under which they are usually sold. A sale of 50 boxes of X brand soap or of 10 tons of Y brand mustard oil, is a sale of goods by description. In such cases the goods supplied must be the same as the goods described.

Examples :

- (i) A certain quantity of copra cake was sold “not warranted free from defect”. The copra cake was adulterated with castor beans to such an extent that it could not be described as copra cake. Held, there was a violation of the implied condition and the buyer was awarded damages. *Pinnock Bros. v. Lewis & Peat Ltd.*⁵
- (ii) M sold to L, 3100 cases of canned fruits, each case to contain 30 tins each. M delivered 3100 cases, but about half the cases contained 24 tins each. Although the market value of the 24 tin cases were the same as the 30 tin cases, it was held that the buyer was entitled to reject the goods. *Re Moore & Co. and Landauer & Co.*⁶

3. Sale by sample. When goods are to be supplied according to a sample agreed upon, the following conditions are implied (Sec. 17):

- (a) The bulk shall correspond with the sample in quality.
- (b) The buyer shall have a reasonable opportunity of comparing the goods with the sample.
- (c) The goods shall be free from any defect rendering them unmerchantable, which would not be apparent on reasonable examination of the sample. If the defect is easily discoverable on inspection and the buyer takes delivery after inspection, he has no remedy.

Examples :

- (i) Two parcels of wheat were sold by sample. The buyer went to inspect the goods. One parcel was shown, not both. Held, the buyer was entitled to rescind the contract. *Lorymer v. Smith.*⁷
- (ii) Some mixed worsted coatings were sold by sample. It was found that owing to a hidden defect of the cloth which could not be detected on reasonable examination, coats made out

⁵ (1923) 1 K.B. 690

⁶ (1921) 2 K.B. 519

⁷ (1822) 1 B & C 1

of it could not stand ordinary wear and were therefore unsalable. The buyer was held to be entitled to damages. *James Drummond and Sons v. E. H. Van Ingen & Co.*⁹

4. **Sale by sample as well as by description.** When goods are sold by sample as well as by description, the goods shall correspond both with the sample and with the description.—Sec. 15.

Example:

N agreed to sell to G some oil described as "foreign refined rape oil, warranted only equal to sample." The samples contained an admixture of hemp oil and the oil delivered was adulterated in the same way. Held, the oil supplied was not rape oil and therefore the buyer was entitled to reject the goods. *Nichol v. Godts.*¹⁰

5. **Condition as to fitness or quality.** (Sec. 16). There is an implied condition as to *quality or fitness for the purposes of the buyer* under the following circumstances *only* :

A. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or not).

Examples :

- (i) W supplied J with tinned salmon which was poisonous. J fell ill and his wife died as a result of eating the salmon. Held, there was an implied condition of fitness because the seller obviously knew that the salmon was being purchased for consumption. The condition was violated by the grocer and damages were recoverable. *Jackson v. Watson & Sons.*¹
- (ii) A, a milk dealer supplied F with milk which was consumed by F and his family. The milk contained germs of typhoid. F's wife was infected and died. Held, there was a breach of an implied condition of fitness and A was liable to pay damages. *Frost v. Aylesbury Dairy Co., Ltd.*²
- (iii) There was a contract to supply 500 tons of coal for the S. S. "Manchester Importer". The coal supplied was found to be unfit for this ship. It was held that the buyer was entitled to get damages. *Manchester Liners v. Rea Ltd.*³ In this case it was held that a buyer relies on the skill of the seller when he makes known to him the purpose for which the goods are required and the circumstances are such that any reasonable seller would take it that his judgment is being relied upon.
- (iv) The plaintiff, who was a draper and had no special knowledge of hot water bottles, went to a chemist and asked for a "hot water bottle". Held, that the bottle supplied must be fit for use as a hot water bottle. *Preist v. Last.*⁴

⁹ (1887) 12 A.C. 284

¹⁰ (1854) 10 Ex 191

¹ (1909) 2 K. B. 193

(1905) 1 K. B. 608

² (1922) 2 A. C. 74

(1903) 2 K. B. 148

B. An implied condition of fitness may be annexed to a contract of sale by usage of trade or custom of the locality.

C. When goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not) there is an implied condition that the goods are of merchantable quality, that is, fit to sell.

There is one exception to rule C.—If the buyer has examined the goods, there shall be no implied condition as regards defects which that examination ought to have revealed.

Examples of rule C :

- (i) Some motor-horns were to be delivered by instalments. The first instalment was accepted but the second contained a substantial quantity of horns which were damaged owing to bad packing. Held, the buyer was entitled to reject the whole instalment as the goods were not of salable quality. *Jackson v. Rotax Motor etc.*⁵
- (ii) M asked for a bottle of Stone's ginger wine in a restaurant. When he was drawing the cork the bottle broke and M was injured. Held, the sale was one by description and since the bottle was unmerchantable M was entitled to recover damages. *Morelli v. Fitch & Gibbons.*⁶
- (iii) B wanted to purchase some glue. The seller showed him the glue which was stored in his warehouse in casks. B did not have the casks opened, which he could have done easily, but merely looked at the outside of the casks. The glue was found to have defects which would have been found out if B had inspected the contents of the casks. Held, there was no implied condition as to merchantable quality. *Thornett & Fehr. v. Beers & Sons.*⁷

THE DOCTRINE OF CAVEAT EMPTOR

Caveat Emptor is a Latin expression which means "buyers-beware". The doctrine of caveat emptor means that, ordinarily, a buyer must buy goods after satisfying himself of their quality and fitness. If he makes a bad choice he cannot blame the seller or recover damages from him. "The rule probably originated at a time when goods were mostly sold in market overt, and the buyer therefore had every opportunity to satisfy himself as to the quality of the goods or their fitness for a particular purpose, and at common law it was presumed that where the buyer could examine the goods, even though he did not, he relied upon his own skill and judgment."⁸

⁵ (1910) 2 K. B. 937

⁶ (1928) 2 K. B. 636

⁷ (1919) 1 K. B. 436

⁸ Pollock & Mulla, *Indian Sale of Goods Act*.

Subject to certain exceptions, the doctrine of caveat emptor applies to India. Section 16 of the Sale of Goods Act lays down that in a contract for the sale of goods there shall be no implied condition as to quality or fitness for a particular purpose except under the circumstances mentioned under that section. The exceptions are as follows :

(a) Where the buyer relies upon the skill and judgment of the seller. (See examples given under rule A above.)

(b) Where by custom an implied condition of fitness is annexed to a contract of sale. (Rule B above.)

(c) Where there is a sale of goods by description, there is an implied condition that the goods are fit for sale. (See examples under rule C above.)

(d) Where the seller is guilty of fraud. A contract of sale of goods must satisfy all the essential elements of a contract and therefore if the consent of the buyer was obtained by fraud, the seller is not protected by the doctrine of caveat emptor.

In cases not falling under any of the four exceptions noted above, the seller is not liable to any penalty if the goods purchased are found to be unfit by the buyer for the purposes he had in mind.

The case of patented articles : Para 2 of Section 16(1) of the Sale of Goods Act provides that "in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose". Thus if a machine is patented as a "cotton cleaning machine" and is sold as such in the market, there is no implied undertaking by the seller that the machine would clean cotton. If a buyer writes to a manufacturer, "send me one of your patented cotton cleaning machines", he cannot claim damages if he finds the machine useless. But if the buyer asks the manufacturer to supply a machine which will clean cotton, he relies on the judgment of the manufacturer and if the machine supplied is found to be unsuitable, he can claim damages.

Example :

B told a motor car dealer that he wanted a comfortable car suitable for touring purposes. The dealer recommended a car which was being sold under the trade name of X. The car was found to be unsuitable and B sued the dealer for damages. It was held that B had relied on the skill and judgment of the dealer and was entitled to get damages. *Baldry v. Marshall.**

* (1925) 1 K. B. 260

IMPLIED WARRANTIES IN A CONTRACT OF SALE OF GOODS

In the absence of an agreement to the contrary, the following warranties are implied in every contract of sale :

1. The buyer shall have and enjoy quiet possession of the goods. [Sec. 14(b)]. Since disturbance to quiet possession is likely to arise only where the vendor does not possess the right to transfer the goods, this clause may be regarded as an extension of the implied condition of title provided for by Section 14(a).¹

2. There is an implied warranty that the goods shall be free from any charge or encumbrance in favour of a third party not declared or known to the buyer before or at the time when the contract is made.—Sec. 14(c).

The effect of this clause is that if the buyer pays off the charge or encumbrance, he will be entitled to recover the money from the seller.

3. A warranty as to fitness for a particular purpose may be annexed to a contract of sale by a custom or usage of trade.—Sec. 16(3).

LIABILITIES OF THE SELLER APART FROM THE CONTRACT OF SALE

The Sale of Goods Act deals only with the contractual liabilities of the seller. But the seller may also be liable to pay damages under the law of torts if he causes injury by a wrongful act. Such damages may sometimes be recovered by a third party, *i.e.* one with whom the seller never entered into any contract. Some examples are given below.

Examples :

- (i) A sold to C a tin of disinfectant powder knowing that it would be dangerous to open the tin without special care. C without knowledge of the danger, opened the tin, whereupon the powder flew into her eyes and injured them. C sued for damages. Held, A should have warned C of the possible danger and having failed to do so, was liable to pay damages. *Clarke v. Army and Navy Co-operative Society Ltd.*²
- (ii) The plaintiff went to a restaurant with a friend and ordered a bottle of ginger beer manufactured by the defendant. She drank a part of the bottle. When the remainder was poured into the glass, a decomposed snail appeared with the liquid. For the resulting mental and bodily shock,

¹ Pollock & Mulla. *Indian Sale of Goods Act*.

² (1903) 1 K. B. 155

she filed a suit for damages against the manufacturers. Damages were granted. The House of Lords held that a manufacturer of goods, intended for consumption, is under a duty to take reasonable care that the goods are free from defects which render them noxious or dangerous. *Donoghue v. Stevenson*.^a

EXERCISES

1. Explain the difference between a condition and a warranty. Under what circumstances can a breach of condition be treated as a breach of warranty? (C. A., Nov. '52).
2. State the conditions implied in a sale of goods, (i) goods by description; (ii) goods by sample; (iii) goods required for a particular purpose. (C. A., May '54).
3. (a) In a contract of sale of goods by sample, what are the implied conditions? (C. U. '51; C. A., May '52).
 (b) There was a sale by sample of mixed worsted coatings, to be in quality and weight equal to the samples. The goods owing to a latent defect, would not stand ordinary wear, when made up into coats and were therefore, not merchantable. The same defect appeared in the samples but could not be detected on a reasonable examination. Is the buyer entitled to recover damages? Give reasons. (C. U. '51).
4. State the implied conditions and warranties in a contract of sale. (C. A., Nov. '54).
5. Explain the doctrine of Caveat Emptor and state the exceptions to it. (C. U. '49; C. A., Nov. '55)
6. Write notes on: Caveat Emptor. (C. U. '59).

^a (1932) A. C. 562

CHAPTER 3

TRANSFER OF OWNERSHIP

Sale of goods involves transfer of ownership or property from the seller to the buyer. It is necessary to determine the precise moment of time at which the ownership of the goods passes from the seller to the buyer, because of the following reasons :

1. The general rule is that risk passes with the property. If the goods are lost or damaged by accident or otherwise, then, subject to certain exceptions, the loss falls on the person who is the owner at the time when the goods are lost or damaged.

2. When there is danger of the goods being damaged by the action of third parties it is the owner who can take action.

3. In case of insolvency of either the buyer or the seller it is necessary to know whether the goods will be taken over by the official assignee. The answer depends upon whether the ownership of the goods is with the party who has become insolvent.

WHEN DOES PROPERTY PASS FROM THE SELLER TO THE BUYER ?

Sections 18 to 25 of the Sale of Goods Act lay down the rules which determine when property passes from the seller to the buyer. These rules may be summarised as follows :

~~1.~~ 1. **Unascertained Goods.** When there is a contract for the sale of unascertained goods, property in the goods is *not* transferred to the buyer unless and until the goods are ascertained. (Sec. 18). An agreement to sell 50 maunds out of a large quantity of rice in a godown does not make the buyer the owner of anything. He can become owner of 50 maunds of rice only after this quantity of rice has been separated out from the other rice in the godown. "The individuality of the thing to be delivered" must be established before property in it can pass from the seller to the buyer. Per Lord Ellenborough in, *Busk v. Davis*.¹

2. **The Intention of the Parties.** In a contract for the sale of specific or ascertained goods, the property passes at such time as the parties to the contract intend it to pass. For the purpose of ascer-

¹ (1814) 2 M & S 397

taining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case. If the intention of the parties cannot be otherwise determined, the rules mentioned below are to be applied.—Sec. 19.

3. Specific Goods. Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed.—Sec. 20.

Property passes at the time of entering into the contract of sale if the following conditions are fulfilled :

- (i) The goods are specific goods.
- (ii) The goods can be immediately delivered.
- (iii) The contract of sale is without any condition.
- (iv) The parties themselves have not fixed a different time for the passing of property.

["Deliverable State"—Goods are said to be in a 'deliverable state' when they are in such state that the buyer would under the contract be bound to take delivery of them.—Sec. 2(3)].

Example :

On the 4th January, a haystack lying on the seller's land was sold. It was agreed that the price was to be paid on 4th February, the haystack will remain on the seller's land till 1st May and no hay was to be cut till the price was paid. The haystack was destroyed by fire. Held, the property in the haystack had passed on the making of the contract and the buyer must bear the loss. *Tarling v. Baxter*.²

4. When seller has something to do. Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof.—Sec. 21.

Example :

The contents of a cistern of oil was sold, the oil was to be filled into casks by the seller and then taken away by the buyer. Some of the casks were filled in the presence of the buyer but, before the remainder could be filled, a fire broke out and the entire quantity of oil was destroyed. Held the buyer must bear the loss of the oil which was put into casks and the seller must bear the loss of the remainder. *Rugg v. Minett*.³

² (1827) 6 B & C 360

³ 11 East 210. Modified example quoted from Pollock & Mulla, *op. cit.*

5. When goods are to be measured, tested etc. Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.—Sec. 22.

Example :

A certain quantity of bark was sold at a fixed price per ton. It was agreed that for determining the money payable by the buyer, the bark would be weighed by the agents of the parties. After a certain quantity was weighed and taken away, the rest was carried away by flood. Held, the buyer is liable to pay for the part taken away by him and the loss of the remainder must be borne by the seller. *Simmons v. Swift*.⁴

6. Unconditional Appropriation. Unconditional appropriation means doing something which identifies and determines the actual goods to be delivered. Property passes when such unconditional appropriation is made by one party with the consent of the other.

Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either, by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.—Sec. 23(1).

Example :

G sold to P, 140 bags of rice out of his stock (sale of unascertained goods). After the price was paid G sent a delivery order for 125 bags and wrote a letter saying that the remaining 15 bags were ready for delivery at his warehouse. P sent for the 15 bags after about a month, when it was discovered that the bags were stolen. Held, there was unconditional appropriation of the 15 bags by the seller, there was implied consent of the buyer to the appropriation (because he did not object) and therefore property in the 15 bags had passed to the buyer. He must therefore bear the loss and is not entitled to get back the price paid by him for them. *Pignataro v. Gilroy*.⁵

7. Delivery to the carrier. Where in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.—Sec. 23(2).

⁴ (1826) 5 B & C 857

⁵ (1919) 1 K. B. 549

The general rule is that when the seller delivers the goods to a carrier for being taken to the buyer, there is unconditional appropriation on his part and the property passes to the buyer. To this rule there is one exception : property does not pass if the seller reserves the "right of disposal" of the goods.

Reservation of the Right of Disposal. (Sec. 25). Reservation of the right of disposal means any action by the seller which expresses an intention on his part not to part with control over the goods until certain conditions are fulfilled. In such cases, the property passes when the conditions are fulfilled.

An intention to reserve the right of disposal may be presumed under the following circumstances :

(a) When a Bill of Lading makes the goods deliverable to the order of the seller.

(b) When the Bill of Lading for the goods and the Bill of Exchange for the price are sent together and the Bill of Lading is deliverable to the buyer only when the Bill of Exchange is accepted or paid.

Examples :

(i) X sends certain goods by lorry for delivery to W. The property passes to W as soon as the goods are handed over to the carrier.

(ii) X sends certain goods by lorry to Y and instructs the lorry driver not to deliver the goods until the price is paid by Y to the lorry driver. The property passes only when the price is paid.

8. Goods sent on approval or "on sale or return". (Sec. 24). When goods are delivered to the buyer on approval or "on sale or return" or other similar terms, the property therein passes to the buyer—

(a) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction;

(b) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time.

Examples :

(i) K delivered some jewellery to X on sale or return. X pawned the jewellery with A. Held, X's act amounts to an acceptance of the sale transaction and hence A's rights are protected. *Kirkham v. Attenborough.*^o

- (ii) Certain goods were delivered to A on sale or return. A delivered the goods to B on similar terms, B to C, and C to D, D lost the goods. Held, since A was unable to return the goods to the seller, the sale was complete and he must pay the price. *Genn v. Winkel.*
- (iii) P sends certain books to Q on approval. Q does not return them or ask the seller to take them away, for six months. He is deemed to have approved the sale and must pay the price.

PASSING OF RISK

Section 26 lays down the rules regarding the passing of risk. The general rule is that goods remain at the seller's risk until the ownership is transferred to the buyer. After the ownership has passed to the buyer, the goods are at the buyer's risk whether delivery has been made or not. "Risk follows ownership." (See examples given under the previous section.)

There are two exceptions to the rule stated above.

1. Where delivery has been delayed through the fault of either the buyer or the seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.
2. The parties may agree that the risk will pass at a time different from the time when ownership passed. For example, the seller may, in a particular case, agree to be responsible for the goods even after the ownership has passed to the buyer.

TRANSFER OF TITLE BY A NON-OWNER

The general rule is that only the owner of goods can sell the goods. No one can convey to a transferee a better title than he himself has. If a person transfers articles not belonging to him, the transferee gets no title. This principle is expressed by the latin phrase, "*Nemo dat qui non habet*", which means "none can give who does not himself possess". This rule applies to both movable and immovable property. But as regards movable goods it is subject to certain exceptions noted below. In each of the following cases, a person who is not an owner, can give to the transferee a valid title to the goods :

1. **Estoppel.** Under certain circumstances the true owner may be prevented, by his conduct, from denying the seller's authority to sell. Suppose that X is the owner of certain goods. X acts in such a manner that Y is induced to believe that the goods belong to Z. On that belief Y buys the goods from Z. Under these circumstances, the court will not allow X to prove his ownership. Thus Y gets a good

title to the goods even though he has purchased them from Z who is not their owner.

Example :

; P, the owner of certain machinery, left them in the possession of Q. A person named R, who had obtained a decree against Q, seized the goods in execution of the decree. P took no steps for several months to claim the goods. He also conversed with R's solicitor regarding the execution without mentioning his title to the machinery. R then had the machinery sold in execution. It was held that P was estopped from denying that the machinery was Q's. Pickard v. Sears.^a

2. **Sale by a mercantile agent.** Sale of goods by a mercantile agent gives a good title to the purchaser, even in cases where the agent acts beyond his authority, provided the following conditions are satisfied (Sec. 27) :

- (i) The agent is in possession of the goods or of a document of title to the goods.
- (ii) Such possession is with the consent of the owner.
- (iii) The agent sells the goods in the ordinary course of business.
- (iv) The purchaser acts in good faith and has no notice that the agent had no authority to sell.

[**"Mercantile Agent"**—"Mercantile agent" means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods.—Sec. 2(9)].

3. **Sale by one of several joint owners.** If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them from such joint owner provided the buyer acts in good faith and without any notice that the seller had no authority to sell.—Sec. 28.

4. **Sale of goods obtained under a voidable agreement.** When the seller of goods has obtained possession thereof under a voidable agreement but the agreement has not been rescinded at the time of sale, the buyer obtains a good title to the goods, provided he buys them in good faith and without notice of the seller's defect of title.—Sec. 29.

Example :

. X buys a ring from Y at a low price by undue influence and sells it to Z who is an innocent purchaser without notice of X's defective title. Z has a good title and Y cannot recover the ring from him even if the agreement with X is subsequently rescinded.

^a (1937) 6 A. & E. 469

It is to be noted that the above section applies when the goods have been obtained under a *voidable* agreement, not when the goods have been obtained under a *void* or *illegal* agreement. If the original agreement is of no legal effect (*void ab initio*) the title to the goods remains with the true owner and cannot be passed on to anybody else.

Example :

In *Cundy v. Lindsay* (see Book II, Ch. 7) goods were obtained by an agreement which was found to be void. It was held that no title passed to the buyer though he was a bona fide purchaser for value and without notice of any defect in the seller's title.

5. Sale by the seller in possession of goods after sale. Where a person, having sold goods, continues to be in possession of the goods or of the documents of title to the goods, a transfer of title by him or his agent by way of sale or pledge, gives a good title to the transferee provided the transferee was acting in good faith and had no knowledge of the seller's want of title.—Sec. 30(1). The original buyer in such cases can obtain damages from the seller but cannot recover the goods from the second buyer.

Example :

X buys a picture from a shop and leaves it with the shopkeeper. The shopkeeper sells it to Y who has no knowledge of the previous sale. Y gets a good title. X's only remedy is to proceed against the shop-keeper for damages.

["*Document of title to goods*" includes a bill of lading, dock-warrant, warehousekeeper's certificate, wharfingers' certificate, railway receipt, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.—Sec. 2(4)].

6. Buyer in possession of goods over which the seller has some rights. When goods are sold subject to some lien or right of the seller (for example for unpaid price) the buyer may sell, pledge, or otherwise dispose of the goods to a third party and give him a good title, provided the following conditions are satisfied.—Sec. 30(2) :

- (i) The first buyer is in possession of the goods or of the documents of title to the goods with the consent of the seller.
- (ii) The transfer is by the buyer or by a mercantile agent acting for him.

- (iii) The person receiving the same acts in good faith and without notice of any lien or other right of the original seller.

Example :

Furniture was delivered to X under an agreement that the price was to be paid in two instalments, the furniture to become the property of X on payment of the second instalment of the price. X sold the furniture before the second instalment was paid. It was held that there was a binding agreement by X to buy the goods and therefore a transfer by him to a bona-fide purchaser for value without notice conveyed a good title.

Lee v. Butler.^o

Cases not coming within the exceptions. It is to be noted that apart from the cases mentioned above, the general rule applies, and no seller can give a better title than he himself has. Some examples are given below.

Examples :

- (i) X found a ring. He made a reasonable search for the owner but did not find him. He then sold the ring to Y. It was held that the true owner can recover the ring from Y. *Farquharson Bros. v. King & Co.*¹
- (ii) A horse was sold at a public auction. The horse was stolen property but this was not known to either the auctioneer or the buyer. Held, the true owner can recover the horse. *Lee v. Bayes.*²
- (iii) B let out a motor car on hire to M at £15 per month. It was agreed between the parties that M could purchase the car by paying in all £424 at any time within 24 months. After a few months M pledged the car with C. B sued to recover the car from C. It was held that as M had only an option to purchase, he cannot give a good title to C and hence B can recover the car. *Belsize Motor Supply Co. v. Cox.*³

The principle of the above case can be applied to *hire-purchase agreements*. Where a hire-purchase agreement creates a binding agreement to sell, or amounts to a sale, section 30 (2) applies and if the goods are resold, the buyer gets a good title. But if the hire-purchase agreement merely gives an option to purchase, a resale by the original buyer gives no title to the second buyer.

EXERCISES

1. In a contract for the sale of goods, state when (a) the property. (b) the risk, in the goods sold passes from the seller to the buyer. (C.U. '55)

2. (a) What are the rules for ascertaining the intention of the parties as to the time when the property in the specific goods is to pass to the buyer? (C.U. '53; C.A., Nov. '52)

^o (1893) 2 Q. B. 318

¹ (1902) A. C. 325

² (1856) 18 C. B. 599

³ (1914) 1 K. B. 244

(b) *A*, the owner of a stack of hay, contracts to sell it to *B*, weigh and deliver it at Rs. 100 per ton. *B* agrees to take and pay for it on a certain day. Part is weighed and delivered to *B*. When will the ownership of the residue pass to *B*? (C.U. '53)

3. "No seller of goods can give the buyer of goods a better title to those goods than he himself has." Critically examine this proposition and state whether there are any exceptions to this rule. (C.U. '56)

4. Enumerate the circumstances under which persons other than the real owners of goods can sell the same and give a good title to the purchasers. (C.U. '52; C.A., Nov. '51)

5. *A* sent a piano to *B* on sale or return. After a week from the date of the receipt of the piano by *B*, *B* pledged it as a security of a loan advanced to him by *C*. Does *C* get a good pledge? Or, is *A* entitled to insist on the return of the piano to him by *C*? (C.A., May '52)

6. Explain what is meant by reservation of the right of disposal in sale of goods. (C.A., May '50)

7. (a) The general law is that no seller of goods can give the buyer of goods a better title to the goods than he himself has. Explain.

(b) Are there any exceptions to the above general law? If so, what are they? (C.U. '58)

8. What are unascertained goods? When does property pass in a contract for the sale of such goods? (C.U. '59)

9. "No one can give what one has not." How does this maxim apply in case of sale of goods? Fully discuss. (C.U. '60)

CHAPTER 4

PERFORMANCE OF THE CONTRACT OF SALE

DUTIES OF THE SELLER AND BUYER

It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale.—Sec. 31.

Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange of the price, and the buyer shall be ready and willing to pay the price in exchange of possession of the goods.—Sec. 32.

The seller of goods has the duty of giving delivery according to the terms of the contract and according to the rules contained in the Sale of Goods Act.

The buyer of goods has the following duties :

1. He must pay the price of the goods according to the terms of the contract.
2. If he wrongfully refuses to accept delivery, he must pay compensation to the seller.
3. Under certain circumstances he is liable to pay interest on the unpaid price.

RULES RELATING TO DELIVERY OF GOODS

“Delivery” is defined in the Act as a “voluntary transfer of possession from one person to another.”—Sec. 2 (2).

Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.—Sec. 33.

The mode of giving possession is to be determined by the parties. Delivery may be actual or constructive. When the goods themselves are delivered it is called actual delivery. Constructive delivery means the delivery of the “means of obtaining possession of the goods”, *e.g.*, delivery of the bill of lading with which the goods can be obtained.

Part Delivery—Delivery of part of the goods may amount to delivery of the whole if it is so intended and agreed. But where a part

is delivered with the intention of severing the part from the whole, there is no delivery of the remainder.—Sec. 34.

Examples :

- (i) Some goods, lying at a wharf, were sold and the seller instructed the wharfinger to give delivery to the buyer. The buyer weighed the goods and took away a part of them. There is delivery of the whole. If the part remaining on the wharf is lost the loss will fall on the buyer. *Hammond v. Anderson*.¹
- (ii) X sold 5 bales of certain goods to Y. B received and paid for one bale and refused to accept the others. This amounts to part delivery. *Mitchell Reid & Co. v. Buldeo Doss*.²

Rules regarding Delivery. The Sale of Goods Act lays down the following rules regarding delivery and other matters concerning the performance of the contract of sale :

1. Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery.—Sec. 35.

2. Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each case on the contract, express or implied, between the parties. Apart from any such contract, goods sold are to be delivered at the place at which they are at the time of the sale, and goods agreed to be sold are to be delivered at the place at which they are at the time of the agreement to sell, or, if not then in existence, at the place at which they are manufactured or produced.—Sec. 36(1).

3. Where under the contract of sale the seller is bound to send the goods to the buyer, but no time for sending them is fixed, the seller is bound to send them within a reasonable time.—Sec. 36(2).

4. Where the goods at the time of sale are in the possession of a third person, there is no delivery by seller to buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf.—Sec. 36(3).

5. Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.—Sec. 36(4).

6. Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state shall be borne by the seller.—Sec. 36(5).

7. Delivery of the Wrong Quantity. (1) Where the seller delivers to the buyer a quantity of goods less than he contracted to sell,

¹ 8 R. R. 763

² 15 Cal 1

the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate.—Sec. 37(1).

(2) Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest, or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate.—Sec. 37(2).

(3) Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest, or may reject the whole.—Sec. 37(3).

(4) The provisions of Section 37 are subject to any usage of trade, special agreement or course of dealing between the parties.—Sec. 37(4).

8. Instalment Delivery. (1) Unless otherwise agreed, the buyer of goods is not bound to accept delivery thereof by instalments.—Sec. 38(1).

(2) Where there is a contract for the sale of goods to be delivered by stated instalments which are to be separately paid for, and the seller makes no delivery or defective delivery in respect of one, or more instalments, or the buyer neglects or refuses to take delivery or pay for one or more instalments, it is a question in each case depending on the terms of the contract and the circumstances of the case, whether the breach of contract is a repudiation of the whole contract, or whether it is a severable breach giving rise to a claim for compensation, but not to a right to treat the whole contract as repudiated.—Sec. 38(2).

9. Delivery to the Carrier or Wharfinger. (1) Where, in pursuance of a contract of sale, the seller is authorised or required to send the goods to the buyer, delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer, or delivery of the goods to a wharfinger for safe custody, is *prima facie* deemed to be a delivery of the goods to the buyer.—Sec. 39(1).

(2) Unless otherwise authorised by the buyer, the seller shall make such contract with the carrier or wharfinger on behalf of the buyer as may be reasonable having regard to the nature of the goods and the other circumstances of the case. If the seller omits so to do, and the goods are lost or damaged in course of transfer or whilst

in the custody of the wharfinger, the buyer may decline to treat the delivery to the carrier or wharfinger as a delivery to himself, or may hold the seller responsible in damages.—Sec. 39(2).

(3) Unless otherwise agreed, where goods are sent by the seller to the buyer by a route involving sea transit, in circumstances in which it is usual to insure, the seller shall give such notice to the buyer as may enable him to insure them during their sea transit, and if the seller fails so to do, the goods shall be deemed to be at his risk during such sea transit.—Sec. 39(3).

10. Where the seller of goods agrees to deliver them at his own risk at a place other than that where they are when sold, the buyer shall, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods necessarily incident to the course of transit.—Sec. 40.

11. **Buyer's right of examining goods.** (1) Where goods are delivered to the buyer which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract.—Sec. 41(1).

(2) Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.—Sec. 41(2).

12. **Acceptance.** The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act, in relation to them which is inconsistent with the ownership of the seller, or when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.—Sec. 42.

13. **Buyer not bound to return rejected goods.** Unless otherwise agreed, where goods are delivered to the buyer and he refuses to accept them, having the right so to do, he is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them.—Sec. 43.

14. **Liability of Buyer.** When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not within a reasonable time, after such request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods.—Sec. 44.

EXERCISES

1. Does the Indian Sale of Goods Act provide for any rules as to delivery? If so, what are the rules? (C.U. '51, 57; C.A., May '52)
2. Enumerate the duties of the seller in respect of the sale of goods. (C.A., Nov. '52)

CHAPTER 5

REMEDIAL MEASURES

RIGHTS OF THE UNPAID SELLER

✓ **Who is an unpaid seller?** The seller of goods is deemed to be an unpaid seller (a) when the whole of the price has not been paid or tendered or (b) when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.—Sec. 45(1).

Suppose that goods worth Rs. 500 are sold. The seller is deemed to be an unpaid seller under any of the following circumstances :

(a) If the whole of the purchase price (Rs. 500) is not paid on the due date.

(b) If payment is made in the form of a negotiable instrument (bill of exchange or cheque) and the instrument is dishonoured.

The term 'seller' includes any person who is in the position of a seller, e.g., the agent of the seller. ?

✓ **Unpaid Seller's Rights.** The Sale of Goods Act gives the following rights to the unpaid seller. [These rights can be exercised even in cases where the *property* in the goods has passed to the buyer.]) — ✓

1. **Seller's Lien or Vendor's Lien** (Sections 47-49). The unpaid seller of goods, who is in possession of them, is entitled to retain possession until payment or tender of the price in the following cases :

- (a) where the goods have been sold without any stipulation as to credit;
- (b) where the goods have been sold on credit but the term of credit has expired;
- (c) where the buyer becomes insolvent.

The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

If the goods have been sold on credit, the seller cannot refuse to part with possession unless the term of credit has expired. —

Example :

Goods are sold on 1st November on condition that the price is to be paid on 1st December. The seller must give delivery. But

if the buyer does not take delivery and the seller is in possession on 1st December, the seller can refuse to part with possession till the price is paid.

Lien can be exercised for non-payment of the price, not for any other charges.

Example :

The seller cannot claim lien for godown charges which he had to incur for storing the goods in exercise of his lien for the price.

When an unpaid seller has made a part delivery of the goods he can exercise lien on the balance of the goods not delivered unless the part delivery was made under such circumstances as to show an intention to waive the lien.

The seller can abandon or waive the lien if he so desires.

The unpaid seller does not lose his lien by reason only that he has obtained a decree for the price of the goods. -

The unpaid seller of goods loses his lien thereon in the following cases :

- (a) Where he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods;
- (b) when the buyer or his agent lawfully obtains possession of the goods; and
- (c) by waiver thereof.

2. The right of Stoppage in Transit. (Sections 50-52). When the buyer of goods becomes insolvent, and the goods are in course of transit to the buyer, the seller can resume possession of the goods from the carrier. This is known as the right of stoppage in transit. The following points are to be noted in connection with the right of stoppage in transit :

(i) The goods are deemed to be in course of transit from the time they are delivered to the carrier to the time they are delivered to the buyer or his agent.

(ii) The right of stoppage in transit comes to an end as soon as the goods are delivered to the buyer or his agent. The carrier may become the agent of the buyer under some circumstances e.g. if after the arrival of the goods at the appointed destination, the carrier acknowledges to the buyer that he holds the goods on his behalf. The seller's right to resume possession comes to an end in such a case. A shipowner carrying goods may be acting as the agent of the buyer if the circumstances so indicate.

(iii) If the carrier wrongfully refuses to deliver the goods to the buyer, the transit is at an end, and the seller's right is lost.

(iv) Where a part delivery has been made, the remainder of the goods may be stopped in transit unless it is shown that the part delivery was made under such circumstances as to show an agreement to give up possession of the whole of the goods.

(v) The term insolvent is used here to denote a person who is financially embarrassed. It is not necessary that the buyer should be declared insolvent by a court of law before the right of stoppage in transit can be exercised.

(vi) The right of stoppage in transit is to be exercised by the seller by taking actual possession or by giving notice to the carrier to redeliver the goods to the seller. The carrier, upon such notice being given, is bound to redeliver the goods to the seller or his agent. The expenses of redelivery must be borne by the seller.

3. The Right of Resale. (Sec. 54). The unpaid seller who has retained possession of the goods in exercise of his right of lien or who has resumed possession from the carrier upon insolvency of the buyer, can resell the goods :

(i) If the goods are of a perishable nature, without any notice to the buyer, and

(ii) In other cases after notice to the buyer, calling upon him to pay or tender the price within reasonable time, and upon failure of the buyer to do so.

If the money realised upon such resale is not sufficient to compensate the seller, he can sue the buyer for the balance. But if he receives more than what is due to him, he can retain the excess.

A resale does not absolve the buyer from his liabilities to compensate the seller for damages he may have suffered.

The person who buys the goods upon such resale gets a good title even if the seller has failed to give notice to the first buyer. But if no notice is given and the goods are sold, the seller cannot sue the first buyer for damages for breach of contract and must pay back to the first buyer any profit which he has realised from the resale (*i.e.* the amount received in excess of the original price).

4. Suit for the Price. (Sec. 55). Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods.

Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or

refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract.

CONSEQUENCES OF BREACH OF CONTRACT OF SALE

In addition to the rights given to the unpaid seller, the Sale of Goods Act gives the following rights to the aggrieved parties when there is a breach of contract of sale of goods :

1. **Damages for non-acceptance.** Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance.—Sec. 56.

2. **Damages for non-delivery.** Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.—Sec. 57.

3. **Specific Performance.** In any suit for breach of contract to deliver specific or ascertained goods, the Court may, if it thinks fit, on the application of the plaintiff, by its decree direct that the contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment of damages. The decree may be unconditional, or upon such terms and conditions as to damages, payment of the price or otherwise, as the Court may deem just, and the application of the plaintiff may be made at any time before the decree. The power of the court to order specific performance in such cases is to be used subject to rules contained in the Specific Relief Act regarding specific performance of contracts.—Sec. 58.

4. **Remedy for Breach of Warranty.** Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods; but he may—

(a) set up against the seller the breach of warranty in diminution or extinction of the price ; or

(b) sue the seller for damages for breach of warranty.—Sec. 59.

5. **Repudiation of Contract.** Where either party to a contract of sale repudiates the contract before the date of delivery, the other may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.—Sec. 60.

6. **Interest and Special Damages.** The seller or the buyer may

CHAPTER 6

THE RULES REGARDING AUCTION SALES

The following rules are contained in the Sale of Goods Act regarding sale of goods by auction. (Sec. 64):

1. Where goods are put up for sale in lots, each lot is *prima facie* deemed to be the subject of a separate contract of sale.

2. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner; and until such announcement is made, any bidder may retract his bid.

A bid by an intending buyer is construed as an offer. As an offer, it can be withdrawn any time before acceptance, which in this case occurs by the fall of the hammer, or any other customary manner. It has been held that it is customary in this country to repeat the final offer three times.¹

Since an offer can be refused, and a bid is an offer, it follows that the auctioneer is not bound to accept the final or any other bid. A lot can be withdrawn after bidding had taken place for some time.

A combination between intending buyers not to bid against each other is known as a "knock out" agreement. Such agreements are not illegal. *Jyoti v. Jhownmull*.²

3. A right to bid may be reserved expressly by or on behalf of the seller. If such right is expressly reserved, the seller or any one person on his behalf may, bid at the auction.

4. Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person; and any sale contravening this rule may be treated as fraudulent by the buyer.

5. The sale may be notified to be subject to a reserved or upset price, *i.e.* there may be a price below which the goods will not be sold. The reserve price may be kept secret.

¹ 14 Mad 235

² 36 Cal 134

6. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

EXERCISE

1. State the rules regarding sales by auction. (C.A., Nov. '57).

BOOK IV
THE LAW OF PARTNERSHIP
CHAPTER I
NATURE OF PARTNERSHIP

The Indian Partnership Act of 1932 (Act IX of 1932) applies to partnerships created by agreement between parties. The Act is not retrospective; it does not affect any right, title, interest, obligation or liability acquired or incurred before the act came into operation in 1932. (Sec. 74). The Act is not exhaustive. It does not apply to joint Hindu family firms.

THE ESSENTIAL ELEMENTS OF A PARTNERSHIP

(Section 4 of the Partnership Act defines a partnership as follows : "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.") A partnership, as defined in the Act, must have three essential elements :

1. There must be an agreement entered into by two or more persons.
2. The agreement must be to share the profits of a business.
3. The business must be carried on by all or any of them acting for all.

The *first element* shows the voluntary contractual nature of partnership. (A partnership can only arise as a result of an agreement, express or implied, between two or more persons. Where there is no agreement there is no partnership.

"The relation of partnership arises from contract and not from status; and, in particular the members of a Hindu undivided family carrying on a family business, as such, or Burmese-Buddhist husband and wife carrying on business, as such are not partners in such business."—Sec. 5.

Examples :

- (i) The relationship between members of a joint Hindu family governed by the Mitakshara school of Hindu law is determined by birth and not by agreement. Therefore a joint family firm is not a partnership under the Act.

- (ii) The sole proprietor of a business dies leaving a number of heirs. The heirs inherit the stock in trade of the business including the goodwill of the business but do not become partners until there is an agreement, express or implied, to carry on the business as partners. *Habib Bux v. Samuel Fitz & Co*¹

The *second element* states the motive underlying the formation of a partnership. It also lays down that the existence of a business is essential to a partnership. Business includes any trade, occupation or profession. If two or more persons join together to form a music club it is not a partnership because there is no business in this case. But if two or more persons join together to give musical performances to the public with a view to earning profit, there is a business and a partnership is formed.

The *third element* is the most important feature of partnership. It states that persons carrying on business in partnership are agents as well as principals. The business of a firm is carried on by all or by any one or more of them on behalf of all. Every partner has the authority to act on behalf of all and can, by his actions, bind all the partners of the firm. Each partner is the agent of the others in all matters connected with the business of the partnership. The law of partnership has therefore been called a branch of the law of agency.

✓ **The Tests of a True Partnership.** In a true partnership, all the essential elements mentioned above must be present. Section 6 of the Partnership Act lays down that in determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties; as shown by all relevant facts taken together.

If all the relevant facts taken together show that all the three essential elements are present, the group of persons doing business together will be called a partnership.

Of the three elements, the second element, viz., sharing of profits, is important but not conclusive. Sharing of profits may exist under circumstances where there is no question of partnership. As examples the following cases may be cited :

- (i) A creditor taking a share of profits in lieu of interest and part-payment of principal.
- (ii) An employee getting a share of profits as remuneration.
- (iii) Share of profits given to workers as bonus.
- (iv) Share of profits given to the widow or children of deceased partners as annuity.

In all the above cases the third essential element of partnership, viz. agency, is absent. A creditor or an emp'oyee, or the widow and children of deceased partners cannot bind the firm by any act done on behalf of the firm. *(Only those who have authority to bind the firm by their actions can be called partners.)* Thus, the most important test of partnership is agency and authority.)

The tests of a true partnership were first laid down by the House of Lords in the case of *Cox v. Hickman*.² In that case, a debtor transferred his business to trustees with instructions to carry on the business and use the profits for paying his cred'tors. It was held that the creditors were not partners of the business. Section 6 of the Partnership Act is a comprehensive restatement of the rule laid down in this case.

Circumstances which the court must take into consideration in determining the existence of partnership: The court must take into account all the relevant circumstances, e.g. the terms of the agreement, if any; the conduct of the parties; the mode of doing business; who controls the property; the mode of keeping accounts; the manner of distribution of profits etc.

Sharing of losses: Sharing of losses is a consequence of partnership rather than a test of partnership. Losses are not mentioned in the definition of partnership as given in Section 4. But in determining whether a partnership exists or not, the court must take into account how losses are shared.

PARTNERSHIP AND CERTAIN SIMILAR ORGANISATIONS

Partnership and Co-ownership. Co-ownership means joint ownership. *A* and *B* jointly purchase a horse. They are co owners but not necessarily partners. The distinction between co-ownership and partnership can be described as follows :

1. In a partnership each partner is the agent of the others but a co-owner is not the agent of the other owners. The rights of a co-owner cannot be affected by any act done by the other owners.
2. Partnership always arises out of agreement. Co-ownership may arise by agreement or by operation of law. *A* and *B* inherit a house from their father. They become co-owners by operation of the law of inheritance.

3. A co-owner can transfer his interest to a third party without the consent of the other co-owners. A partner can transfer his interest,

² (1860) 8 H. L. C. 268

under certain circumstances, but the transferee can never become a partner of the business without the consent of the other partners.

4. A partnership always implies a business. Co-ownership may exist without any business, e.g. joint ownership of a residential house.

5. Since co-ownership may exist without a business, the question of sharing profits or losses is immaterial in a co-ownership. In a partnership there must be sharing of profits.

6. A partner has a lien on the partnership assets for moneys spent by him for the partnership. A co-owner has no lien under similar circumstances.

Partnership and a Club. A club is an 'association of persons' formed for social purposes. It differs from a partnership in the following respects—it is not a business; there is no motive of earning profits and sharing them; a member of a club is not the agent of the other members; a member is not responsible for the debts of the club unless he participated in the transaction; and the death or resignation of a member does not affect the existence of the club.

Partnership and a Company. See under Book V.

Partnership and a Joint Hindu Family Firm. A Hindu joint family which carries on a trade inherited from its ancestors is called a Hindu Joint Family Firm. Such firms are very common in India, particularly among Hindus governed by the Mitakshara school. The points of difference between such a firm and a contractual partnership can be enumerated as follows :

1. A partnership is created by agreement; a joint family firm is created by operation of law. Membership of a joint family firm is the result of status, i.e. position of the person concerned as member of a joint family or coparcenary.

2. In a joint family firm the manager or *Karta* has authority to bind the members by all acts coming within the scope of the joint family business but no other member has any such authority. In a partnership every partner has authority to bind the firm by his actions and can participate in the business of the firm.

3. In a partnership every partner is liable to an unlimited extent for the debts of the firm. In a joint family firm only the *Karta* has unlimited liability; the other members are liable only to the extent of their share in the joint family business.

4. The minor members of a joint family are members of the firm from the date of their birth. (In a partnership a minor cannot be a member (except in one special case).) The reason is that a

partnership is the result of an agreement and a minor does not have capacity to enter into an agreement.

5. The death of a member of a joint family firm has no effect on the firm. The firm continues with the other members. In a partnership, death of a partner dissolves the firm, unless otherwise agreed by the partners.

6. A member of a joint family firm when severing his connection with the firm cannot ask for accounts of past profits and losses, but a partner of a firm under similar circumstances can.

7. A partnership is governed by the Partnership Act; a joint family firm is governed by Hindu law.

PARTNERSHIP FORBIDDEN BY LAW

1. Section 11 of the Companies Act 1956 prohibits the formation of a partnership for the purpose of carrying on the business of banking with more than ten persons and for any other purpose with more than twenty persons. If it is desired to carry on business with more than 10 or more than 20 persons for banking and non-banking business respectively, a company must be formed.

2. An agreement to form a partnership for the purpose of carrying on a trade which is prohibited by law is void.

SPECIFIC PERFORMANCE

As a general rule, the courts will not pass a decree for the specific performance of an agreement to enter into and carry on a partnership. The reason is that such an agreement is of a personal nature.

SOME DEFINITIONS

Firm, Firm-name, Partner. Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm" and the name under which their business is carried on is called the "firm-name."—Sec. 4, para 2.

(A firm is not an artificial person like a company.) It is merely a collective name for the individuals who are trading in partnership.

The partners may select any firm-name they please, subject to the following restrictions :

- (i) They must not select a name which will fraudulently imply that their business is the same as some other competing concern.

- (ii) They cannot use words like 'President', 'Royal' etc. which will imply that the firm is enjoying the patronage of the state.

The names of all the partners may be used together as the firm-name or the name of any particular partner may be so used. It may happen that the name of a partner is used as the firm-name but that name is identical with the firm-name of a rival trader. This is not illegal. A man is entitled to use his own name for carrying on business even though it is identical with the name of another person carrying on a similar business. But if there is any fraudulent intention, he may be stopped from doing so. *Turton v. Turton*.³

Partnership-at-will. A partnership is called a partnership-at-will (i) when the partnership is *not* for a fixed period of time and (ii) when no provision is made as to when and how the partnership will come to an end.—Sec. 7.

A partnership-at-will can be dissolved whenever any partner chooses to do so.

✓ **Particular Partnership.** A particular partnership is one which is formed for a particular adventure or a particular undertaking. (Sec. 8). Such a partnership is usually dissolved on the completion of the adventure or undertaking.

✓ **Limited Partnership.** In Great Britain, according to the provisions of the Limited Partnership Act of 1907, a partnership may be formed, in which the liability of all partners (except one) is limited. There must be at least one partner with unlimited liability. In India there is no such provision. In India the liability of all the partners must be unlimited.

Partnership Property. The property of the firm includes all property and rights and interests in property originally brought into the stock of the firm, or acquired by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business.—Sec. 14.

Thus, property of the firm means (i) property originally brought in by the partners (ii) property obtained while the firm was in business and (iii) the goodwill of the firm.

Unless the contrary impression appears, property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm.

Subject to contract between partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business.—Sec. 15.

Examples of Partnership Property : A partnership is formed with X, Y and Z as partner. X contributes to the stock of the firm a plot of land, Y a motor lorry and, Z the sum of Rs. 10,000. Subsequently the firm purchases, out of its earnings, a house. All these properties, and the goodwill of the business, are properties of the firm.

Goodwill. (Goodwill is a term easy to describe but difficult to define.) It is not defined in the Partnership Act. Generally speaking, goodwill may be described as the advantage which is acquired by a firm (over and above the value of the stock-in-trade and capital and funds) from the connections it has built up with its customers and the reputation it has gained. Vice-Chancellor Wood, in *Charton v. Douglas*¹ defined goodwill as follows : "Goodwill, I apprehend, must mean every advantage . . . that has been acquired by the old firm in carrying on its business, whether connected with the premises in which the business was previously carried on, or with the name of the late firm, or with any other matter carrying with it the benefit of the business."

Goodwill is a part of the property of the firm. Section 55 of the Partnership Act provides that in settling the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other property of the firm.

The Partnership Agreement. The agreement to carry on business in partnership may be oral or in writing. If it is in writing, the document in which the terms are incorporated is called the Deed of Partnership or the Articles of Partnership.

Written documents of partnership usually contain exhaustive provisions regarding all possible matters concerning the business and the relationship between the partners. The following matters are generally included : name and address of the partners; firm-name; nature of business; place of business and the business address; duration of the partnership and the mode of dissolution; the amount of capital to be contributed by each partner; the share of profits to be taken by each partner; the mode of management; the powers of the partners; terms on which a partner can retire; expulsion of partners; introduction of new partners.

¹ (1859) 28 L. J. Ch. 841, 845

REGISTRATION OF FIRMS

The registration of a partnership is not compulsory. But an unregistered firm suffers from certain disabilities and therefore registration is necessary for carrying on business.

The formalities of registration. (Sections 56-71). The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of Firms of the locality, a statement in the prescribed form and accompanied by the prescribed fee, stating the following particulars : (a) the firm-name, (b) the place or principal place of business of the firm, (c) the names of any other places where the firm carries on business, (d) the date when each partner joined the firm, (e) the names in full and permanent addresses of the partners, and (f) the duration of the firm.

The statement shall be signed and verified by all the partners, or their agents specially authorised on this behalf. On receipt of the statement and the fees, the Registrar records an entry of the statement in the Register of Firms and the firm is thereupon considered to be registered.

Alterations in any of the above particulars have to be recorded.

The Register of Firms can be inspected and copies of entries taken by any person on payment of the necessary fees.

Under Section 56 of the Act, the Government of any State may, by notification, declare that the provisions relating to the registration of firms shall not apply to the State or any part thereof.

Consequences of non-registration. (Sec. 69). An unregistered firm and the partners thereof suffer from certain disabilities :

1. A partner of an unregistered firm cannot file a suit (against the firm or any partner thereof) for the purpose of enforcing a right arising from contract or a right conferred by the Partnership Act.

2. No suit can be filed on behalf of an unregistered firm against any third party for the purpose of enforcing a right arising from a contract.

3. An unregistered firm cannot claim a set-off in a suit. ['Set off' means a claim by the defendant which would reduce the amount of money payable by him to the plaintiff.]

The effect of Section 69 is (i) to bar all suits by an unregistered firm against third parties for the enforcement of rights arising from contracts and (ii) to bar all suits between partners *inter se* for the enforcement of partnership rights. The section does not bar suits in respect of torts, *i.e.* civil suits for damages for the violation of a right.

Exceptions: There are certain exceptions to the rules stated above.

1. A partner of an unregistered firm can file a suit for the dissolution of the firm and for accounts.

2. Suits can be filed for the realisation of the properties of a dissolved firm even though it was unregistered.

3. The Official Assignee or Receiver can realise the properties of an insolvent partner of an unregistered firm.

4. There is no bar to suits by unregistered firms and by the partners thereof in areas where the provisions relating to the registration of firms do not apply by notification of a State Government under Section 56.

5. An unregistered firm can file a suit (or claim a set off) for a sum not exceeding Rs. 100 in value, provided the suit is of such a nature that it has to be filed in the Small Causes Court. Proceedings incidental to such suits, e.g. execution of decrees, are also allowed.

EXERCISES

1.) What are the essential elements of partnership? (C.U. '47). How does it differ from co-ownership? (C. U. '49; '54).

2. Must a firm be registered? What are the consequences of non-registration of a firm? (C. U. '57).

3. Define partnership.

"The members of a Hindu undivided family carrying on a family business as such... are not partners in such business." Explain. (C. U. '51).

4. State what the application for the registration of a firm should contain. (C. U. '53; C.A., Nov. '52).

5.) Define a partnership. What is the test of determining whether a partnership between A and B does or does not exist? (C. U. '55).

6. What tests would you apply to determine the existence of partnership? (C.A., Nov. '49; May '51; Nov. '53).

7. "Although sharing of profits is an essential element of partnership, it is not the sole test." Comment. (C.A., May '60).

8. A manager shares in the profits as well as the losses of a business. Is he a partner in the business? What do you consider to be the most important test for determining the existence of a partnership? (C.A., May '61).

9. What is Partnership Property? How far is it liable for a Partner's separate debts? (C. U. B.Com. '62).

CHAPTER 2

RIGHTS AND LIABILITIES OF PARTNERS

RELATION OF PARTNERS TO ONE ANOTHER

The mutual rights and duties of the partners of a firm may be determined by contract between the partners. Such contract may be express or may be implied from the course of dealings of the firm. The mutual rights and duties may be altered any time with the consent of all the partners.—Sec. 11(1).

The Partnership Act lays down *two general rules* regarding the conduct of the partners to one another.

1. "Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative."—Sec. 9.

This section lays down that the relationship between partners is one of utmost good faith. Though partners are not trustees for one another, it has been held in some cases that the relationship between them is of a fiduciary character.

2. "Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm."—Sec. 10.

This rule follows logically from the rule laid down in the previous section. Since partnership implies utmost good faith, (a partner must not act fraudulently against the firm. If he does, he must make up the loss.)

Subject to the general principles stated above the following rules are laid down in the Act regarding the relationship between the partners as regards the management of the business and their mutual rights and duties :

1. **Rules regarding the conduct of the business.** Subject to any agreement to the contrary, the following rules apply as regards the management of a firm :

(a) every partner has a right to take part in the conduct of the business;

(b) every partner is bound to attend diligently to his duties in the conduct of the business;

- (c) any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners, and every partner shall have the right to express his opinion before the matter is decided but no change may be made in the nature of the business without the consent of all the partners; and
- (d) every partner has a right to have access to and to inspect and copy any of the books of the firm.—Sec. 12.

Subject to contract between the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business.—Sec. 15.

The partners may distribute the work of management among themselves in any way they like. There may be a partner who takes no active part in the business. Such a partner is called a *Dormant Partner* or a *Sleeping Partner*.

The partnership contract may provide that a partner shall not carry on any business other than that of the firm while he is a partner. Such an agreement is not void on the ground of restraint of trade.—Sec. 11(2).

2. Mutual rights and duties. Subject to any contract to the contrary, the mutual rights and duties of partners are as follows :

- (a) a partner is not entitled to receive remuneration for taking part in the conduct of the business;
- (b) the partners are entitled to share equally in the profits earned and shall contribute equally to the losses sustained by the firm;
- (c) where a partner is entitled to interest on the capital subscribed by him such interest shall be payable only out of profits;
- (d) a partner making, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six per cent. per annum;
- (e) the firm shall indemnify a partner in respect of payments made and liabilities incurred by him—
 - (i) in the ordinary and proper conduct of the business, and
 - (ii) in doing such act, in an emergency, for the purpose of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances; and
- (f) a partner shall indemnify the firm for any loss caused to

it by his wilful neglect in the conduct of the business of the firm.—Sec. 13.

3. Secret Profits. Subject to contract between the partners.

- (a) If a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;
- (b) if a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.—Sec. 16.

Examples :

- (i) A partner without the knowledge of his other partners obtained for his own benefit the renewal of the lease of the business premises of the firm. Held, the renewed lease was partnership property. *Featherstonehaugh v. Fenwick*.¹
- (ii) P and Q were partners of a firm. Q was appointed to buy sugar for the firm. Without the knowledge of P, he supplied his own sugar to the firm at the market price and made large profits. Held, he must make over the profits to the firm. *Bentley v. Craven*.²

4. Continuance of pre-existing terms. Subject to contract between the partners, the relationship between them is presumed to remain the same if the constitution of the firm changes for any reason, or if the firm was for a fixed period and continues to exist after the expiry of the term, or when business not included in the original contract is undertaken.—Sec. 17.

**RELATION OF PARTNERS TO THIRD PARTIES
THE AUTHORITY OF A PARTNER**

[A partner is the agent of the firm for the purposes of the business of the firm.] (Sec. 18). When two or more persons agree that they would carry on a business jointly and share the profits earned thereby, each is a principal and each is an agent for the others. Each is bound by any of the other's contracts entered into with third parties in course of the business of the partnership. The principle of agency governs the relationship between the partners. It has therefore been said that the law of partnership is a branch of the law of agency.

The authority of a partner to act on behalf of the firm can be divided into two categories : Express Authority and Implied Authority.

Any authority which is expressly given to a partner by the agree-

¹ (1810) 17 Ves. 298

² (1853) 18 Beav. 75

ment of partnership is called Express Authority. The firm is bound by all acts done by a partner by virtue of any express authority given to him.

Implied Authority means the authority to bind the firm which arises by implication of law from the fact of partnership. Section 19 of the Act lays down that the act of a partner which is done to carry on, *in the usual way, business of the kind carried on by the firm*, binds the firm. Section 22 provides that in order to bind a firm, an act or instrument done or executed by a partner (or other person on behalf of the firm) shall be done or executed *in the firm name*, or in any other manner expressing or implying an *intention to bind the firm*.

Examples :

- (i) X, the partner of a firm of confectioners, purchases sugar on credit in the firm name. The firm is bound to pay for the sugar.
- (ii) P, the partner of a firm of confectioners, purchases a horse on credit in the firm name. The firm is not bound in the absence of any express authority from the other partners because this act does not come within the scope of a confectioner's business.
- (iii) Y, the partner of a firm borrows money in his personal name. The firm is not bound because it is not an act of the firm.

Limitations of a partner's Implied Authority. [Sec. 19 (2)] : In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to—

- (a) submit a dispute relating to the business of the firm to arbitration,
- (b) open a banking account on behalf of the firm in his own name,
- (c) compromise or relinquish any claim or portion of a claim by the firm,
- (d) withdraw a suit or proceeding filed on behalf of the firm,
- (e) admit any liability in a suit or proceeding against the firm,
- (f) acquire immovable property on behalf of the firm,
- (g) transfer immovable property belonging to the firm, or
- (h) enter into partnership on behalf of the firm.

Alteration of Authority. (Sec. 20) : The express or implied authority of a partner may be altered, extended, or restricted by agree-

ment between the partners at any time. But notwithstanding any such restrictions, any act done by a partner which falls within the implied authority of a partner, binds the firm unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.

Authority in an Emergency. (Sec. 21) : A partner has authority in an emergency, to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm.

Liability of a firm for Wrongful Acts of a Partner. (Sections 26 and 27) : Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefor to the same extent as the partner.

Where—

- (a) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or
- (b) a firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm,

the firm is liable to make good the loss.

Admission by a Partner. (Sec. 23) : An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary course of business.

Notice to a Partner. (Sec. 24) : Notice to a partner who habitually acts in the business of the firm of any matter relating to the affairs of the firm operates as notice of the firm, except in the case of a fraud on the firm committed by or with the consent of that partner.

From the above it follows that a notice to a dormant partner is not notice to the firm.

LIABILITY OF A PARTNER FOR ACTS OF A FIRM

Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner.—Sec. 25.

This section lays down the rule that every partner is liable, to

an unlimited extent, for all debts due to third parties from the firm incurred while he was a partner.

As between the partners, the liability is adjustable according to the terms of the partnership agreement. Thus if a partner is entitled to receive $1/4$ th share of profits, he is liable to pay $1/4$ th share of the losses. The accounts between the partners will be adjusted on this basis. But a third party, who is a creditor of the firm, is entitled to realise the whole of his claim from any one of the partners.

There is no difference between working partners and dormant partners as regards liability to third parties. A dormant partner also is liable to an unlimited extent for all debts of the firm.

✓PARTNERSHIP BY HOLDING OUT OR ESTOPPEL

A person may, under certain circumstances, be liable for the debts of a firm although he is not a partner. If a person, by words spoken or written, or by conduct, represents himself or knowingly permits himself to be represented, to be a partner in a firm, he is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm.—Sec. 28.

If X induces Y to believe that X is a partner of a firm AB and Y , believing that X is a partner, gives credit to AB , X will be responsible for compensating Y . He will not be heard to say that he is not a partner of AB . This is known as partnership by Holding Out or Estoppel.

Examples :

- (i) Two brothers A and B carry on a business in the family name. Another brother C , having the same name attends the place of business and behaves with outsiders as if he was a partner. C is liable as a partner by holding out.
- (ii) X carried on business as $R. S. \& Co.$ and employed a person named $R. S.$ to act as manager of the business. It was held that $R. S.$ is a partner by the principle of estoppel. *Bevan v. The National Bank Ltd.*^{*}

To hold a person liable as a partner by holding out, it is necessary to establish the following :

1. He represented himself, or knowingly permitted himself to be represented as a partner.
2. Such representation occurred by words spoken or written or by conduct.
3. The other party on the faith of that representation gave credit to the firm.

^{*} (1906) 23 T. L. R. 65

It is not necessary that there should be any fraudulent intention on the part of the person holding himself out as partner. Nor is it necessary that he should be aware of the fact that a person is giving credit on the faith of the representation.

A partner by holding out is liable to make good the loss which the person giving credit, may suffer. But thereby he acquires no claim upon the firm.

A partner who has retired from the firm but allows the use of his name in connection with the firm may become liable to third parties by the principle of holding out. But the legal representatives of a deceased partner do not become liable for the debts of the firm merely because the name of the deceased is used as a part of the firm name.

MINOR ADMITTED AS A PARTNER

A minor cannot enter into a contract of partnership because an agreement by a minor is void. But if all the partners agree, a minor may be admitted to the benefits of an existing firm. The rights and liabilities of such a minor partner are governed by the following rules. (Sec. 30):

1. The minor has a right to such share of the property and of the profits of the firm as may be agreed upon by the partners.

2. The minor may have access to and inspect and copy any of the accounts of the firm.

3. The share of the minor in the profits and in the assets of the firm are liable for the acts of the firm but the minor is not personally liable for any such act. (His own properties are not liable).

4. So long as the minor continues to be a member of the firm, he *cannot* file a suit against the other partners for an account or for the payment of his share of the property or profits of the firm. He can file such a suit only when he wants to sever his connection with the firm. [If the minor files such a suit, the minor's share shall be determined by valuation in accordance, as far as possible, with the procedure laid down in Sec. 48 of the Act for taking accounts of a dissolved partnership.]

5. At any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor may give public notice that he has elected *to become* or that he has elected *not to become* a partner in the firm. Such notice shall determine his position as regards

the firm. If he gives *no* notice, he shall become a partner of the firm on the expiry of the said six months.

[**“Public Notice”**—The mode of giving public notice is laid down in Section 72 of the Act. In the case of a registered firm: (i) a copy of the notice is to be sent to the Registrar of Firms and (ii) a copy must be published in the local official Gazette and in at least one vernacular newspaper circulating in the district where the firm has its place or principal place of business. In the case of unregistered firms, only (ii) is necessary.]

[If the minor wants to take advantage of the fact that he had no knowledge of being admitted into the benefits of a partnership, the burden of proving such lack of knowledge is upon him.]

6. The following rules apply when a minor elects to become a partner or becomes a partner by failing to notify otherwise :

- (a) His rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes *personally liable* to third parties for all acts of the firm done since he was admitted to the benefits of partnership.
- (b) His share in the property and profits of the firm shall be the share to which he was entitled as a minor.

7. The following rules apply when the minor elects not to become a partner:

- (a) His rights and liabilities continue to be those of a minor up to the date on which he gives public notice.
- (b) His share is not liable for any acts of the firm done after the date of the notice.
- (c) He is entitled to sue the partners for his share of the property and profits of the firm.

RECONSTITUTION OF A FIRM

The constitution of a firm may be changed by the introduction of a new partner; death, retirement, insolvency and expulsion of a partner; or by the transfer of a partner's share to an outsider. All these cases are included within the term Reconstitution of a firm. Upon reconstitution, the rights and liabilities of the incoming and out-going partners have to be determined. The provisions of the Partnership Act regarding such cases are stated below.

Introduction of a New Partner. (Sec. 31) : A new partner can be introduced only with the consent of all the partners. The share of

profits which a new partner is entitled to get is fixed at the time he becomes a partner. He is liable for all the debts of the firm after the date of his admission but he is not responsible for any act of the firm done before he became a partner, unless otherwise agreed. These rules do not apply to a minor becoming a partner under Section 30.

Retirement of a Partner. (Sec. 32) : A partner may retire (a) with the consent of all the other partners, (b) in accordance with the terms of the agreement of partnership, or (c) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement if it is so agreed *with the third party* and the *partners of the reconstituted firm*. Such agreement may be implied from the course of dealing between the firm and the third party after he had knowledge of the retirement.

The retired partner continues to remain liable to third parties for all acts of the firm until public notice is given of the retirement. Such notice may be given either by the retired partner or by any member of the reconstituted firm.

[The mode of giving Public Notice is laid down in Sec. 72 of the Act. See above.]

A retired partner is not liable for the debts of the firm incurred after public notice of his retirement.

Expulsion of a Partner. (Sec. 33) : A partner can be expelled only when the following conditions are fulfilled :

- (a) When the contract of partnership contains a provision for expulsion under stated circumstances.
- (b) The power to expel is exercised in good faith by the majority of the partners.
- (c) The expelled partner has been given notice of the charges against him and has been given an opportunity to answer the charges. *Carmichael v. Evans*.⁴

The liabilities of an expelled partner for the debts of the firm are the same as those of a retired partner.

Insolvency of a Partner. (Sec. 34) : When the partner of a firm is adjudicated an insolvent, he ceases to be a partner from the date on which the order of adjudication was passed by the court. Whether the firm is thereby dissolved or not depends on the terms of the agreement between the partners.

⁴ (1904) 1 Ch. 486

If the firm is dissolved, the usual procedure in case of dissolution is adopted (*i.e.* the assets are collected and the debts and charges are paid). If any balance remains due to the insolvent out of the assets, the same is handed over to the official assignee or the official receiver.

If the firm is not dissolved by the insolvency, the share of the insolvent partner vests in the official assignee or the official receiver. Thereafter the estate of the insolvent partner is not liable for any act of the firm and the firm is not liable for any act of the insolvent done after the date of the order of adjudication.

Death of a Partner. (Sec. 35) : Ordinarily the death of a partner has the effect of dissolving the firm. But it is competent for the partners to agree that the firm will continue to exist even after the death of a partner.

Where the firm is not dissolved by the death of a partner, the estate of the deceased partner is not liable for any act of the firm done after his death.

Transfer of a Partner's Interest. (Sec. 29) : A partner may transfer his interest in a firm to an outsider. The transfer may be absolute or partial. The interest may also be sold to a third party in execution of a decree of a court. The transferee in such cases gets very limited rights over the firm. His rights can be described as follows :

1. The transferee does not become a partner of the firm. He cannot interfere in the conduct of the business or require accounts or inspect the books of the firm.

2. The transferee is entitled to receive the share of profits of the transferring partner. But he has to accept the account of profits agreed to by the partners.

3. If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled, as against the remaining partners, to receive the share of the assets of the firm to which the transferring partner is entitled. For the purpose of ascertaining that share, the transferee is entitled to an account *as from the date of dissolution*.

Sub-partnership. The transferee of a share of a partner's interest in a firm is sometimes called a Sub-partner and the relationship a Sub-partnership. Suppose that *X*, the owner of $\frac{1}{4}$ share of a firm, transfers $\frac{1}{2}$ of his share to *Y*. The transferee *Y* becomes a sub-partner.

The position of a sub-partner is the same as that of a transferee of a partner's interest. (See above).

RIGHTS OF AN OUTGOING PARTNER

1. By a special agreement among the partners, an outgoing partner may be prevented from carrying on a similar business within a specified period or within specified local limits. Such an agreement is valid and is an exception to the general rule that agreements in restraint of trade are void.—Sec. 36(2).

2. If there is no restraining agreement, an outgoing partner may carry on a business competing with that of the firm and he may advertise such business. But, subject to contract to the contrary, he may not (a) use the firm name (b) represent himself as carrying on the business of the firm or (c) solicit the custom of persons who were dealing with the firm before he ceased to be a partner.—Sec. 36(1).

3. Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled *at the option of himself or his representatives* to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm;

Provided that where by contract between the partners an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.—Sec. 37.

4. A continuing guarantee given to a firm or to a third party in respect of the transactions of a firm, is, in the absence of agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.—Sec. 38.

EXERCISES

1. What are the rights and obligations of a minor in a partnership ? (C. U. '59)
2. What do you understand by the implied authority of a partner as agent of the firm ? (C.U. '48; C.A., May '52; Nov. '54)
3. What is partnership property ? For what purposes can it be used ? (C.A., Nov. '50; C.U. '56)
4. What is meant by partnership by holding out and what are the rights and liabilities flowing therefrom ? (C A., May '53)
5. Examine the rights and liabilities of (i) a new partner (ii) a retiring partner and (iii) an insolvent partner. (C.A., Nov. '52)
6. What are the rights of an outgoing partner and a sub-partner ? (C.A., Nov. '55)
7. Explain the circumstances under which a person, even though not a partner, can nevertheless be made liable as a partner. (C.A., Nov. '59)
8. How far can a partner of a firm be considered as an agent of the other partners ? (C.U. '61)

CHAPTER 3

DISSOLUTION OF FIRMS

What is Dissolution? Dissolution of a firm means the end of a firm by the break up of the relation of partnership between *all* the partners. Dissolution is to be distinguished from reconstitution of a firm. In the latter case, the partnership continues but there is a change in the number of partners. In the former case there is complete severance of jural relations between all the partners.

THE GROUNDS OF DISSOLUTION

A firm may be dissolved on any one of the following grounds :

1. **By agreement.** A firm may be dissolved any time with the consent of all the partners of the firm. Partnership is created by contract, it can also be terminated by contract.—Sec. 40. .

2. **By notice.** Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution, or, if no date is mentioned, as from the date of communication of the notice.—Sec. 43. .

3. **On the happening of Certain Contingencies.** (Sec. 42). Subject to contract between the partners, a firm is dissolved—

- (a) if constituted for a fixed term, by the expiry of that term;
- (b) if constituted to carry out one or more adventures or undertakings, by the completion thereof;
- (c) by the death of a partner; and
- (d) by the adjudication of a partner as an insolvent.

The partnership agreement may provide that the firm will not be dissolved in any of the aforementioned cases. Such a provision is valid.

4. **Compulsory Dissolution.** A firm is dissolved—

- (a) by the adjudication of all the partners or of all the partners but one as insolvent, or
- (b) by the happening of any event which makes the business of the firm unlawful.

But if a firm has more than one undertaking, some of which become unlawful and some remain lawful, the firm may continue to carry on the lawful undertakings.—Sec. 41.

5. **Dissolution by the Court.** At the suit of a partner, the court may dissolve a firm on any one of the following grounds : (Sec. 44).
 (a) If a partner becomes insane. (The suit for dissolution in this case can be filed by the next friend of the insane partner or by any other partner).

(b) If a partner becomes permanently incapable of performing his duties as a partner. Permanent incapacity may arise from an incurable illness like paralysis. In *Whitwell v. Arthur*,¹ a partner was attacked with paralysis which on medical evidence was found to be curable. Dissolution was not granted.

The suit for dissolution in this case must be brought by a partner other than the person who has become incapable.

(c) If a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business. To justify dissolution under this clause the misconduct must be of such a nature as to affect adversely the particular business concerned. Misconduct which affects one business may not affect another business. Therefore the court must take into account the nature of business that the partnership carries on. The test generally applied is whether the act complained of is likely to affect the *credit and custom* of the particular business.

Examples :

- * (i) The partner of a firm of solicitors was convicted of travelling on the railway without a ticket and with intent to defraud. It was held that since the conviction was for dishonesty, it was likely to be detrimental to the partnership business and dissolution was granted. *Carmichael v. Evans*.²
- (ii) In English cases dissolution has been granted for the following acts—conviction for an offence involving moral turpitude; misapplication of the monies of a client by a solicitor; adultery by a doctor; speculation in shares by the partner of a regular mercantile business.³

The suit for dissolution on the ground mentioned in this clause must be brought by a partner other than the partner who is guilty of misconduct.

(d) If a partner wilfully and persistently commits breach of the partnership agreement regarding management, or otherwise conducts

¹ (1865) 35 Beav. 140

² (1940) 1 Ch. 486

³ Lindley, (9th. edition), p. 690

himself in such a way that it is not reasonably practicable for the other partners to carry on business in partnership with him.

Examples :

In English cases the following acts have been held to be sufficient ground for directing dissolution : refusing to account for monies received; taking away the books of account; the application of monies belonging to the firm in payment of his private debts; continued quarrelling, and such a state of animosity as precludes reasonable hopes of reconciliation and friendly co-operation.⁴

The suit for dissolution in cases coming under this clause is to be brought by a partner other than the partner guilty of the acts complained of.

(e) If a partner has transferred the whole of his interest in the firm to an outsider or has allowed his interest to be sold in execution of a decree.

Transfer of a partner's interest does not by itself dissolve the firm. But the other partners may ask the court to dissolve the firm if such a transfer occurs. Only the transfer of the entire interest of the partner gives ground for action. The transfer of a part of the partner's interest does not provide any ground for dissolution. The formation of a sub-partnership is, therefore, not a ground for dissolution.

The suit for dissolution on the ground mentioned in this clause must be brought by a partner other than the partner whose interest has been transferred or sold.

(f) If the business of the firm cannot be carried on except at a loss. Since the motive, with which partnerships are formed, is acquisition of gain, the courts have been given discretion to dissolve a firm in cases where it is impossible to make profits.

(g) If the court considers it just and equitable to dissolve the firm. This clause gives a discretionary power to the court to dissolve a firm in cases which do not come within any of the foregoing clauses but which are considered to be fit and proper cases for dissolution.

Examples :

Dissolution has been granted under this clause in the following cases—deadlock in the management; partners not on speaking terms; disappearance of the substratum of the business.

THE CONSEQUENCES OF DISSOLUTION

1. Upon dissolution, the firm comes to an end and its affairs must be wound up according to the rules laid down in the Act. The

⁴ Lindley, p. 691

assets of the firm must be collected and applied in payment of the debts and liabilities. The surplus, if any, is to be distributed among the partners according to their rights. The deficit, if any, is to be paid by the partners according to the terms of the agreement of partnership.

2. Until public notice is given of the dissolution, the partners continue to be liable to third parties for all acts done in connection with the affairs of the firm.—Sec. 45.

3. Notwithstanding the dissolution, the authority of each partner to bind the firm (and the other mutual rights and obligations of the partners) continue (i) so far as may be necessary to wind up the affairs of the firm, and (ii) to complete transactions begun but unfinished at the time of the dissolution.

After dissolution, a partner cannot bind the firm in any case other than the two cases mentioned above. A partner who has been adjudicated insolvent cannot bind the firm in any case after the order of adjudication has been passed.—Sec. 47.

4. If any partner earns any profit from any transaction connected with the firm after its dissolution, he must share it with the other partners and the legal representatives of the deceased partners.—Sec. 50.

5. **Return of Premium.** Where a partner has paid a premium on entering into partnership for a fixed term, and the firm is dissolved before the expiration of that term otherwise than by the death of a partner, he shall be entitled to repayment of the premium or of such part thereof as may be reasonable, regard being had to the terms upon which he became a partner and to the length of time during which he was a partner, unless—

- (a) the dissolution is mainly due to his own misconduct, or
- (b) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.—Sec. 51.

6. Where a contract creating partnership is rescinded on the ground of the fraud or misrepresentation of any of the parties thereto, the party entitled to rescind is, without prejudice to any other right, entitled—

- (a) to a lien on the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him

for the purchase of a share in the firm and for any capital contributed by him;

- (b) to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm; and
- (c) to be indemnified by the partner or partners guilty of the fraud or misrepresentation against all the debts of the firm.—Sec. 52.

7. After a firm is dissolved, every partner or his representative may, in the absence of a contract between the partners to the contrary, restrain any other partner or his representative from carrying on a similar business in the firm name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up. But a partner who has purchased the goodwill of the firm, cannot be restrained from using the firm name.—Sec. 53.

8. Partners may, upon or in anticipation of the dissolution of a firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement will not be void on the ground of restraint of trade.—Sec. 54.

'MODE OF SETTLING ACCOUNTS UPON DISSOLUTION

The settlement of accounts between partners upon dissolution is to take place in the manner provided for in the partnership agreement. Subject to such agreement, the Partnership Act lays down the following rules regarding the matter :

1. Losses are to be paid first out of profits, next out of capital, and, lastly if necessary by the partners individually in the proportions in which they were entitled to share profits. Capital deficiency is to be treated as loss and is to be borne by the partners in proportion to the profit sharing ratio.—Sec. 48(a).

Example :

A, B, & C are three partners in a firm. Their capital contributions are, A—Rs. 10,000, B—Rs. 5,000, C—Rs. 1,000. They share profits equally. Upon dissolution it is found that realisable assets are—Rs. 20,000 and debts payable are—Rs. 13,000.

From the above it follows that, available assets are Rs. 7,000. Therefore capital deficiency is Rs. 9,000. Each partner must contribute Rs. 3,000 towards capital deficiency, because they have equal shares in profits.

The final position is that A is to pay Rs. 3,000 and receive Rs. 10,000; B is to pay Rs. 3,000 and receive Rs. 5,000; C is to pay Rs. 3,000 and receive Rs. 1,000.

C therefore contributes Rs. 2,000. This contribution together with the available assets Rs. 7,000, amounts to Rs. 9,000. Out of this A gets Rs. 7,000 and B gets Rs. 2,000.

2. The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order :

- (a) in paying the debts of the firm to third parties;
- (b) in paying to each partner ratably what is due to him from the firm for advances as distinguished from capital;
- (c) in paying to each partner ratably what is due to him on account of capital; and
- (d) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.—Sec. 48(b).

(3) If a partner becomes insolvent or otherwise cannot pay his share of the contribution, the capital of the solvent partners cannot be returned in full. In this case, the solvent partners must share ratably the available assets (including their own contribution to the capital deficiency) *i.e.* the available assets will be distributed in proportion to their original capital. This result follows from the language of sub-section (ii) of Section 48(b). In the English case, *Garner v. Murray*,³ a similar rule is laid down.

Example :

In the example given above if C is insolvent, he will pay nothing. The available assets will be Rs. 7,000 *plus* Rs. 6,000 (the contributions of A and B) *i.e.* in all Rs. 13,000. The amount will be shared between A and B in the ratio of 2 : 1 which is the ratio between their capital.

4. Where there are joint debts from the firm, and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm, and, if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of his separate debts, and the surplus (if any) in the payment of the debts of the firm.—Sec. 49.

SALE OF GOODWILL AFTER DISSOLUTION

Goodwill is a part of the property of the firm. Section 55 of the Partnership Act provides that in settling the accounts of a firm after

³ (1904) 73 L.J. Ch. 66

dissolution, the goodwill shall, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other property of the firm.

The purchaser of the goodwill gets the exclusive right to represent himself as carrying on the old business. He also gets the exclusive right to use the name of the old firm.

But the sellers of the goodwill (*i.e.* the partners of the old firm) or any one or more of them may carry on a business competing with that of the buyer and may advertise the business. This right is given by Section 55(2) of the Partnership Act because of the general principle that a man may adopt any trade, occupation, or profession that he chooses.

To protect the buyer of the goodwill in case of competition with the partners of the old firm, Section 55(2) provides that such a partner or partners cannot (a) use the firm name (b) represent himself as carrying on the business of the firm, or (c) solicit the custom of persons who were dealing with the firm before its dissolution (unless there is an agreement with the buyer of the goodwill permitting any of these).

The buyer of the goodwill may further protect himself from the competition of the old partners by entering into an agreement with any partner prohibiting such partner from carrying on any business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be valid if the restrictions imposed are reasonable (notwithstanding the fact that the agreement may amount to restraint of trade.)—Sec. 55(3).

EXERCISES

1. What is meant by dissolution of firms? In what different cases will the courts order dissolution of a firm at the suit of a partner? (C.U. '47; '48; '50; '52; C.A., May '51; Nov. '54)
2. What are the consequences of the dissolution of a firm? (C.U. '48)
3. Has any partner after dissolution, authority to bind the firm? (C.U. '49)
4. What do you understand by goodwill of a business? What becomes of the goodwill on dissolution of partnership? (C.U. '56)
5. How are accounts to be settled between partners on dissolution? (C.A., May '50, '52, '54, '55)
6. (a) What are the rights and obligations of partners after dissolution of partnership?
(b) How are accounts settled between partners after dissolution? (C.U. '58)
7. Under what circumstances may a partnership be dissolved by court? (C.U. '60)

BOOK V
COMPANY LAW

CHAPTER I
INTRODUCTION

GENESIS OF THE COMPANIES ACT, 1956

The first legislative enactment in India, regarding companies, was the Joint Stock Companies Act of 1850. This was based upon the English Act of 1844. The Act of 1850 was replaced by a new Act bearing the same name in 1857. In this Act the principle of limited liability was introduced for the first time. The Act was not comprehensive. With the expansion of business and industry and the growing popularity of the corporate form of business organisation, need was felt for more comprehensive company legislation. Acts relating to companies were passed in 1860, 1866, 1882, 1895, 1910 and 1913. The Act of 1913 remained in force up to 1956, though it was extensively amended in 1936 and 1951.

During the post war years it was increasingly felt that the Companies Act of 1913 was inadequate to deal with the problems of Indian industrial and business organisation which were growing more and more complex with the passage of time. The provisions of the Act of 1913, relating to the managing agency system, were extremely inadequate. Also, on account of the large number of amendments which had been made, the Act had become unwieldy and the numbering of the sections had become awkward. The Government therefore appointed, towards the end of 1950, an expert committee under the chairmanship of Sri C. H. Bhaba to suggest how the company law should be reformed with a view to make it better suited for the development of Indian industry and trade. The Companies Act of 1956 (Act I of 1956) is based mainly on the recommendations of the aforesaid committee.

WHAT IS A COMPANY

The Act of 1956 has been extensively amended by The Companies (Amendment) Act, 1960 (Act 65 of 1960).

The term Company is used to describe an association of a number of persons, formed for some *common purpose* and *registered* according to the law relating to companies. Section 3(1) (i) of the Companies Act, 1956 states that a company means, "a company formed and registered under this Act or an existing company."

Lord Justice Lindley defines a company as follows : "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. (The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share.)"

(A company formed and registered under the Companies Act possesses a legal personality. It is regarded by law as a single person, having specified rights and obligations.)

(Because the law confers on a company a distinct personality, it is a *totally different person or thing or entity from its members or the individuals composing it*. Suppose that A, B, C and 50 other persons form a company called Alpha & Co. The company, Alpha & Co., is a legal person quite separate from A, B, C and others. Therefore, A, B, C etc. can enter into contracts with Alpha & Co. This principle is illustrated in the case, *Salomon v. Salomon & Co. Ltd.*¹ Salomon had a business in boot manufacture. He formed a company called Salomon & Co. (with himself, his wife, daughter and 4 sons as shareholders) and transferred to it his business. As consideration for the transfer he received the major portion of the shares of the company and debentures for £10,000. Later on, the company went into liquidation. Salomon claimed, out of the assets of the company, the payment of the amount covered by the debentures *viz.*, £10,000. The unsecured creditors of the company objected on the ground that the business really belonged to Salomon and he should not be allowed to claim as a secured creditor. It was held that Salomon, as an individual, was quite distinct from Salomon & Co. and he could therefore be a secured creditor of the company, even though he happened to hold the majority of the shares. ^

DISTINCTION BETWEEN A PARTNERSHIP AND A COMPANY

The points of difference between a Partnership and a Company can be summed up as follows :

¹ (1897) A.C. 22

INTRODUCTION

VI. A company comes into existence only after registration under the Companies Act. In the case of a partnership, registration is not compulsory.

2. The minimum number of persons required to form a company is 2 in the case of private companies and 7 in the case of public companies. The minimum number of persons required to form a partnership is 2.

3. A public company may have any number of members. A private company cannot have more than 50 members. A partnership carrying on banking business cannot have more than 10 members and partnerships carrying on other types of business cannot have more than 20 members.—Sec. 11.

4. A company is regarded by law as a single person. It has a legal personality. A partnership is a collection of individuals. It is not considered to be a single person.

Even where a single person holds most of the shares of a company, the company has a legal personality separate and distinct from the majority shareholder. *Salomon v. Salomon & Co., Ltd.*¹

5. The property of a partnership is the joint property of the partners. Each partner has authority to bind the firm by his acts. The property of the company belongs to the company. A shareholder in his individual capacity cannot bind the company in any way.

6. The shareholder of a company can enter into contracts with the company and can be the employee of the company. Partners can contract with other partners but not with the firm as a whole.

7. A partnership firm is managed by the partners themselves. The work of management can be distributed among them in any manner they like.

A company is managed by the Board of Directors or Managing Agents or Managing Directors who are selected in the manner provided by the Act. The shareholder, as such, cannot participate in the management.

8. A company has perpetual succession. The death or insolvency of a member does not affect its existence. A partnership, in the absence of a contract to the contrary, comes to an end when a partner dies or becomes insolvent.

9. The liability of the members of a partnership for the debts of the firm is always unlimited. The liability of the members of a company is usually limited.

(10) The creditors of a firm are creditors of the individual partners, and a decree obtained against a firm can be executed against the individual partners. The creditors of a company are not creditors of the individual shareholders and a decree obtained against a company cannot be executed against any shareholder. It can only be executed against the assets of the company.

11. A partner of a firm cannot transfer his interest in the firm to an outsider and make the transferee a partner without the consent of all the other partners. The shareholders of a company can ordinarily transfer his share and the transferee becomes a member of the company.

(12) A company is required to comply with various statutory obligations regarding management *e.g.*, filing balance sheets, maintaining proper account books and registers. In the case of partnerships there are no such statutory obligations.

TYPES OF COMPANIES

There are two types of companies—Public and Private.

Private Company. A private company is one which, by its articles, (a) restricts the right of the members to transfer their shares, if any; (b) limits the number of its members (not counting its employees) to 50; and (c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company—Sec. 3 (1) (iii).

Public Company. All companies other than private companies are called public companies.—Sec. 3(1) (iv).

Public companies may be classified into three types : (i) companies limited by shares (ii) companies limited by guarantee, and (iii) unlimited companies.

Company Limited by Shares. In these companies there is a share-capital, and each share has a fixed nominal value which the shareholder pays at a time or by instalments. The member is not liable to pay anything more than the fixed value of the share, whatever may be the liabilities of the company. Most of the companies in India belong to this class.

Company Limited by Guarantee. In these companies, each member promises to pay a fixed sum of money in the event of the liquidation of the company. This amount is called the guarantee. Sometimes the members are required to buy a share of a fixed value and also give

a guarantee for a further sum in the event of liquidation. There is no liability to pay anything more than the value of the share (where there is a share) and the guarantee.

Unlimited Companies. In these companies the liability of the shareholder is unlimited as in partnership firms. Such companies are very rare.

Private companies may be limited by shares or limited by guarantee. There cannot be a private company with unlimited liability.

SOME DEFINITIONS

Existing Company. [Sec. 3-(1) (ii)]. An "existing company" means a company formed and registered under any of the *previous laws* relating to Companies. The previous laws are : Acts prior to 1866; the Acts of 1866, 1882 and 1913; the Registration of Transferred Companies Ordinance, 1942; and, any law relating to companies in the Part B States and the merged territories.

It is to be noted that under the Companies Act of 1956, unless the context otherwise requires, the following companies are *not* deemed to be included within the terms Company, Existing Company, Private Company and Public Company :—

(a) a company the registered office whereof is in Burma, Aden or Pakistan and which was before the separation of that country from India a company according to Indian company law, and,

(b) a company the registered office whereof is in the State of Jammu and Kashmir and which was a company under Indian Company Law prior to 26th January, 1950.

Holding Company and Subsidiary Company. (Sec. 4). If a company can control the policies of another company through the ownership of its shares or through control over the composition of its Board of Directors, the former is called a Holding Company and the latter is called its Subsidiary.

Sec. 4 of the Act, as amended in 1960, lays down that a company shall be deemed to be a subsidiary of another company only if any one or more of the following conditions are satisfied :

(a) If the composition of its Board of Directors is controlled by the other company.

(b) (i) If it is an existing company in which the holders of preference shares (issued before the commencement of the Act of 1956) have the same voting rights as the holders of equity shares, and the other company exercises or controls more than half of the total voting power of such company; or

(ii) in any other case, if the other company holds more than half in nominal value of its equity share capital.

(c) If it is the subsidiary of a company which is itself the subsidiary of another company. [If company *A* has a subsidiary *B* and *B* has a subsidiary *C*, *C* will be regarded a subsidiary of *A*.]

The following points are to be noted.

(i) The composition of a Company's Board of Directors shall be deemed to be controlled by another company if that other company can appoint or remove the holders of all or a majority of the directorships.—Sec. 4(2).

(ii) In determining whether one company is a subsidiary of another, the shares held in a fiduciary capacity or as security for a loan or by virtue of any provision in any debentures, shall not be counted. But shares held as a nominee shall be counted, except in the three cases mentioned above (in a fiduciary capacity etc.)—Sec. 4(3).

(iii) A foreign company may be treated as a subsidiary under certain circumstances—Sec. 4(6) and (7).

Relative. Section 6 provides that a person shall be deemed to be a relative of another if, and only if, (a) they are members of a Hindu undivided family; or (b) they are husband and wife; or (c) the one is related to the other in the manner indicated in Schedule IA.

Schedule IA contains a list of 49 items like father, mother, mother's mother, daughter's son etc.

Associate. See Chapter 7.

Government Company. (Sec. 617). The Companies Act of 1956 contains certain special provisions regarding Government Companies. A Government Company is defined as one in which not less than 51 per cent of the share capital is held by the Central Government or by any State Government or by two or more of them together. [See *post*, under Ch. 12].

Unregistered Company. (Sec. 582). The term "unregistered company" includes any partnership, association or company consisting of more than seven members, which does not come within any of the following categories :

(i) a railway company incorporated by any Act of Parliament or other Indian law or any Act of Parliament of the United Kingdom;

(ii) a company registered under the Companies Act, 1956; or

(iii) a company registered under any previous company law (except companies with their registered offices in Burma, Aden or

Pakistan, prior to separation of the countries, and companies with their head office in Jammu and Kashmir prior to 26th January, 1950).

Unregistered companies can be wound up according to the provisions of Sections 583-590. [See Ch. 14].

Foreign Company. (Sec. 591). A 'foreign company' means a company incorporated outside India, which,

- (a) after the commencement of the Act, establishes a place of business in India, or
- (b) had a place of business in India prior to the commencement of the Act of 1956 and continues to have the same.

The Act of 1956 contains certain special provisions regarding foreign companies. [See Ch. 13].

DIFFERENCES BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

The distinction between private companies and public companies did not exist prior to 1913. It was first introduced by the Companies Act of that year. The main points of difference between the two types of companies are enumerated below.

- ✓ 1. The number of members in a private company cannot be less than two and cannot be more than fifty. In a public company, the number of members cannot be less than seven but no maximum has been fixed. There may be any number of members.
- ✓ 2. In a private company there must be regulations restricting the transfer of shares. In a public company there need not be any. By restricting transfer, a private company can prevent the membership of persons or classes of persons who are considered to be undesirable.
- ✓ 3. A private company cannot invite the public to purchase its shares or debentures. A public company may do so.
- ✓ 4. A private company must add the words, "Private Limited" at the end of its name.
- ✓ 5. Private companies are given certain privileges which are not enjoyed by public companies.

PRIVILEGES OF PRIVATE COMPANIES AS COMPARED TO PUBLIC COMPANIES

The Companies Act of 1956 gives a large number of privileges to private companies. The important privileges are stated below.

1. *Prospectus*: A private company need not file a prospectus or a statement in lieu of prospectus.—Sec. 70(3).

2. *Issue of new shares*: When a public company proposes to increase its subscribed capital by the issue of new shares, it must comply with certain rules, the most important of which is that such new shares must be offered first to the existing equity shareholders *pro rata*, unless the members in a general meeting decide otherwise. This provision does not apply to private companies.—Sec. 81(3).

3. *Commencement of business*: A private company can commence business immediately on incorporation, whereas a public company has to wait until it obtains a certificate for the Commencement of Business.—Sec. 149(7).

4. *Statutory Meeting and Statutory Report*: A private company need not hold the Statutory Meeting or file the Statutory Report.—Sec. 165(10).

5. *Managerial Remuneration*: In the case of public companies and private companies which are subsidiaries of public companies, the overall maximum managerial remuneration shall not exceed 11 per cent of the net profits, or if there is absence or inadequacy of profits in any year, a sum not exceeding Rs. 50,000. This rule does not apply to a private company which is not a subsidiary of a public company.—Sec. 198.

6. *Offices of profit*: A public company cannot appoint a firm or body corporate to hold an office of profit under it (except the office of managing agent, and secretary and treasurer). A private company, which is not a subsidiary of a public company, may do so,—Sec. 204(6).

7. *Number of directors*: Formerly it was not necessary for private companies to have directors. The Act of 1956, as amended in 1960, provides that a private company must have at least 2 directors and a public company at least 3 directors.—Sec. 252.

8. *Rules regarding directors*: The rules regarding directors are less stringent in the case of private companies which are not subsidiaries of public companies. Examples are given below.

It is not necessary to file with the Registrar the consent of a director to act as such; amendment of articles regarding appointment of wholetime or non-rotational directors do not require the previous sanction of the Government; provisions regarding the share qualifications of directors laid down in Sections 270-272, do not apply; a private company may provide additional grounds for disqualification of directors and their vacation from office; (directors of

private companies may hold office beyond the age of 65; the age of a director need not be recorded in the register of directors;) public companies cannot give loans to directors save in exceptional circumstances, a private company may do so; unlike the directors of a public company, the directors of a private company may participate in the discussions of the Board of Directors where contracts in which they are personally interested are being dealt with; restrictions laid down in the Companies Act regarding the remuneration of directors do not apply to private companies; the restrictions regarding the appointment of managing directors laid down in Section 316 and 317 do not apply to private companies.

9. *Managing Agents* : The Companies Act of 1956 contains many stringent provisions regarding managing agents. But as regards private companies, which are not subsidiaries of public companies, the following concessions are made : the Central Government may by general or special order exempt a private company from compliance with the provisions of Sections 328-331 (terms of office of managing agents; variation of agency agreements; termination of agency contracts); approval of the Central Government is not required for changes in the constitution of managing agents of private companies or changes in the articles regarding their remuneration; there is no restriction on purchasing shares of other companies under the same managing agents; (in the case of public companies the Central Government has power to prevent changes in the Board of Directors which are likely to affect the company prejudicially, but not in the case of private companies.)

10. *Memo of Contract* : In the case of a public company, if an agent enters into an agreement with the company as undisclosed principal, he must make a memorandum of the contract and keep it with the company, otherwise the agreement is not binding on the company. The rule is not applicable to a private company, unless it is a subsidiary of a public company—Sec. 416.

CERTAIN OBLIGATIONS IMPOSED UPON PRIVATE COMPANIES BY THE ACT OF 1956

The Companies Act of 1956 imposes certain obligations on private companies. Some of the important obligations are enumerated below.

1. A private company must add the words, "private limited", at the end of its name. The object of this provision is that the pub-

lic should know whether they are dealing with a public company or a private company.—Sec. 13(1) (a).

2. A private company limited by shares must have articles of association which must be registered along with the memorandum of association.—Sec. 26.

3. If the directors of a private company, which is the subsidiary of a public company, refuse to register the transfer of any shares, the transferor or the transferee may appeal to the Central Government for reversing the decision.—Sec. 111 (3).

4. All private companies must send 3 copies of its Balance Sheet to the Registrar and must also file a copy of the Auditor's Report regarding the balance sheet.—Sec. 220(1) (b).

5. A private company, which acts as the managing agents of another company, must file a declaration in the form laid down in Schedule VIII to the Act.—Sec. 347.

6. A private company must, like a public company, appoint auditors who must be chartered accountants.—Sections 224 and 226.

WHEN A PRIVATE COMPANY LOSES ITS PRIVILEGES

A private company loses its privileges under the following circumstances :

I. If a private company fails to comply with the essential requirements of a private company (*viz.* restrictions on transfer of shares; limitation of the number of members to 50; and, prohibition of invitation to the public to buy shares or debentures) it shall cease to enjoy the privileges of private companies and the company will be treated as if it were a public company.—Sec. 43.

The court may relieve the company from the consequences of non-compliance of the aforesaid restrictions, if it is of opinion that the non-compliance was accidental or was due to inadvertence.

II. Where not less than 25% of the paid up share capital of a private company (having a share capital) is held by one or more bodies corporate, the private company shall become a public company on and from the date on which the aforesaid percentage is first held.—Sec. 43 A.

This section has been added by the amending Act of 1960. The rule also applies to companies where the aforesaid percentage was held before the commencement of the amending Act. But such companies will be treated as public companies from three months after the commencement of the amending Act.

The following further provisions of Section 43A are to be noted.

1. Even after a private company has become a public company by virtue of Sec. 43A, its articles of association may continue to have the three restrictions characteristic of private companies (*viz.* limitation of members to 50, restrictions on the transfer of shares and prohibition of invitation to the public to buy shares). The number of members of such a 'public' company may also be reduced to below 7.

2. In computing the aforesaid percentage, no account shall be taken of the shares of the company held by a Banking Company on trust or as executors etc.

3. Section 43A does not apply to the following cases :

(a) to a private company of which the entire paid up share capital is held by another single private company or by one or more bodies corporate incorporated outside India; or

(b) to any other private company which satisfies *all* the following conditions, *viz.* (i) the shareholding companies are all private companies (ii) no share of a shareholding company is held by a body corporate, and (iii) the total number of shareholders of the shareholding company or the number of shareholding companies together with the individual shareholders does not exceed fifty.

4. A private company must inform the Registrar within 3 months of its becoming a public company under this section. The Registrar shall delete the word 'private' from the name of the company and shall also make the necessary alterations in the Certificate of Incorporation and the Memorandum of Association of the company.

5. A private company becoming a public company under this section shall continue as such until it again becomes a private company by adopting the procedure laid down in the Act.

III. A private company loses its privileges if it converts itself into a public company in accordance with the procedure laid down in Section 44. (See below.)

HOW A PRIVATE COMPANY CAN BECOME A PUBLIC COMPANY

1. Section 44 provides the method by which a private company can be converted into a public company, *viz.*,

(i) by passing a special resolution altering its articles so as to eliminate the three restrictions on private companies (*viz.*, limitation of the number of members to 50; restrictions on the transfer of shares; prohibition of invitation

- to the public to buy shares or debentures) and
(ii) filing with the Registrar, within 14 days, a prospectus or statement in lieu of prospectus.

2. A private company may become a public company by default, as provided in Section 43. (See above).

3. Subject to certain exceptions, a private company becomes a public company if not less than 25% of its shares come under the ownership of one or more bodies corporate.—Sec. 43A. (See above).

CONSEQUENCES OF THE NUMBER OF MEMBERS FALLING BELOW THE MINIMUM PRESCRIBED

If the number of members of a public company is reduced to below 7 and that of a private company to below 2 and the company carries on business for more than six months while the number is so reduced, every person who remains a member after six months and is aware of the fact of shortage of members, shall be personally liable for all the debts of the company contracted during that time.—Sec. 45.

The company can also be wound up by order of court.

COMPANY AND AN ILLEGAL ASSOCIATION

An association of more than 10 persons carrying on business in banking or an association of more than 20 persons carrying on any other type of business must be registered under the Companies Act. If it is not so registered it is deemed to be an illegal association. Such an association suffers from many disabilities. It has no legal existence. It cannot enter into contracts and cannot sue its members or outsiders for money. Every member of such an association is personally responsible for all debts incurred by the association and is also liable to be prosecuted in the criminal courts and fined up to Rs. 1000. The effect of the aforesaid provisions (which are contained in Sec. 11 of the Companies Act) is to make illegal, a partnership business consisting of more than 10 partners in the case of banking companies and more than 20 partners in other cases. But these rules do not apply to the case of a Joint Hindu Family Firm.

The Act contains provisions for the winding up of unregistered associations.

COURTS HAVING JURISDICTION IN COMPANY MATTERS

Suits relating to the constitution of a company and its winding up are ordinarily dealt with in the High Court of the area in which

the registered office of the company is situated. But the Central Government may, by notification, confer power on a District Court to try certain matters relating to companies—Sec. 10.

Suits of other types (e.g. money suits) by or against the company, may be tried by all Courts. Which court will try the suit is determined by the rules regarding jurisdiction of courts as laid down in the Civil Procedure Code.

EXERCISES

1. Distinguish between a private company and a public company. (C.U. '48, '49, '54).
2. "Not only does the legislature recognise the private company; it may be said to bestow its benedictions upon it." Discuss, pointing out specially the privileges enjoyed by a private company and the differences between a private and a public company. (C.A., Nov. '50).
3. What is the effect of the failure by a private company to observe the limitations and restrictions placed upon it by the Companies Act? (C.A., May '54).
4. What is the liability of the member of a private company which continues to do business where the number of member is reduced to below two? (C.A., May '54).
5. Contrast an ordinary partnership from a limited company. (C.A., May '51, '53).
6. (a) (i) An incorporated company is a "totally different person or thing or entity from its members—the individuals comprising it". Explain and illustrate. (ii) What is a private company?
(b) Write short notes on:—(i) Government Company, (ii) Holding Company, (iii) Subsidiary Company, (iv) Existing Company, as in the Companies Act, 1956 (Act I of 1956). (C.U. '57).
7. Explain what is meant by a "holding company" and a "subsidiary company". Give examples. (C. U. B. Com. '62).

CHAPTER 2

THE MEMORANDUM AND ARTICLES OF ASSOCIATION

(The first step in the formation of a company is the preparation of the Memorandum of Association and the Articles of Association of the proposed company.) These two documents must be filed when application is made for the registration and incorporation of the company. The Companies Act lays down elaborate rules regarding the preparation of the memorandum. Schedule I to the Act of 1956 contains four model forms of memorandum for use in different cases.

DEFINITIONS OF MEMO AND ARTICLES AND THE DISTINCTION BETWEEN THEM

(The Memorandum of Association is a document which contains the fundamental rules regarding the constitution and activities of a company.) It is the basic document which lays down how the company is to be constituted and what work it shall undertake. (The purpose of the memorandum is to enable the members of the company, its creditors, and the public to know what its powers are and what is the range of its activities.) The memorandum contains rules regarding the capital structure, the liability of the members, the objects of the company, and all other important matters relating to the company. Because the memorandum is the fundamental charter of the company, it is allowed to be altered only after certain formalities have been observed which ensure discussions by, and publicity to, the parties interested in the affairs of the company.

(The Articles of Association is a document which contains rules regarding the internal management of the company. Articles must not violate any provision of the memorandum or any provision of the Companies Act.) The rules laid down in the articles must always be read subject to the rules contained in the memorandum. Lord Cairns in *Ashbury Railway Carriage & Iron Co. v. Riche*¹, described the relationship between the memorandum and the articles in this language: "The memorandum is as it were, the area beyond which the actions of the company cannot go; inside the area, the

¹ (1875) 7 H.L. 653

shareholders may make such regulations for their own government as they think fit."

The distinction between the memorandum and the articles of association can be summed up as follows :

1. The memorandum is the fundamental charter of the company determining its constitution and objectives, the articles are rules regarding internal management.

2. Any rule in the articles contrary to the memorandum is invalid.

3. Articles can be altered easily, the memorandum can be altered only after the adoption of certain formalities.

The Memo and the Articles are *public documents*, which may be inspected by anybody at the office of the Registrar of Companies. Any person dealing with a company is presumed to have notice of their contents. The members of a company are entitled to have copies of the memo and the articles, on demand and on payment of a fee of Re. 1.

THE FORM AND CONTENTS OF THE MEMORANDUM

Section 13 of the Act lays down that the memorandum of association of every company shall contain the following particulars :

1. The name of the company with the word "limited" at the end of the name of a public company and the words "private limited" at the end of the name of a private company.

2. The name of the State in which the registered office of the company is to be situated.

3. The objects of the company, and, except in the case of trading corporations, the State or States to whose territories the objects extend.

4. The nature of the liability of the members *i.e.*, whether limited by shares or by guarantee or unlimited.

5. In the case of a company having share capital—

- (a) unless the company is an unlimited company, the memorandum shall state the amount of share capital and the division thereof into shares of a fixed amount;

- (b) no subscriber of the memorandum shall take less than one share; and

- (c) each subscriber to the memorandum shall write opposite to his name the number of shares he takes.

Section 14 of the Act lays down that the memorandum shall be according to the prescribed form or as near to it as circumstances admit. The memo must be drafted, as desired, to suit the needs of the company concerned, but the particulars mentioned above must be included, and, there must be nothing contrary to the provisions of the Act.

[In Schedule I to the Act four model forms are given. They relate to the following four types of companies :

Table B, Company Limited by Shares.

„ C. „ „ „ Guarantee and not having a share-capital.

„ D. „ „ „ Guarantee and having a share capital.

„ E. Unlimited Company.]

Section 15 provides that the memorandum must be printed; divided into paragraphs numbered consecutively; and signed by each subscriber (who shall add his address, description and occupation, if any). The signature of the subscriber shall be attested by at least one witness who shall likewise add his address, description and occupation, if any. In the case of public companies the Memo must be signed by at least 7 persons; in the case of private companies by at least 2 persons.

RULES REGARDING THE NAME OF THE COMPANY

A company cannot adopt a name by which another company is registered.) If by inadvertence a name is selected which is the same as that of an existing company or closely resembles it, the name must be changed.

(A company cannot use a name which is considered undesirable by the Central Government.) (Sec. 20). Under the Emblems and Names (Prevention of Improper Use) Act of 1950 the Government has power to declare what names and emblems are not to be used by companies and in trade marks and patents. The use of the following has been prohibited under the above Act—name and emblems of the U.N.O. and the W.H.O.; the Indian National Flag; the official seal and emblems of the Central Government and the State Governments; name and pictorial representations of Mahatma Gandhi and the Prime Minister of India; the 'Interpol'. The Central Government can declare any other name as undesirable and prohibit the use of the same by a company.

(Subject to the above rules, a company can adopt any name it likes.)

The name and the address of the registered office of every company must be painted or affixed on the outside of its business premises in a conspicuous position and in letters easily legible in one or more of the languages used in the locality. (Sec. 147). The words Limited and Private Limited are parts of the names of public and private companies respectively and must be added at the end of the name of the company.

The name and the address of the registered office of the company must be engraven in legible characters on the company's seal and mentioned in all business letters, bill-heads, notices and other documents. (Sec. 147). But they may not be mentioned in advertisements. Failure to publish the name and the address of the registered office in the manner laid down in Section 147, is punishable with a fine.

The Central Government may, by licence, permit the omission of the words Limited or Private Limited in the case of companies which are formed for promoting commerce, art, science, religion, charity or any other useful object, and which are non-profit and non-dividend-paying organisations (*e.g.*, Chambers of Commerce). The licence given may be withdrawn if the company ceases to fulfil the conditions mentioned above.—Sec. 25.

[Procedure for changing the name—see below under “Alteration of Memorandum”.]

RULES REGARDING THE REGISTERED OFFICE

A company shall from the day on which it commences business or within 28 days after incorporation, whichever is earlier, have a registered office to which all communications and notices may be addressed. Notice of the situation of the registered office, and of every change therein, shall be given within 28 days after the date of the incorporation of the company or after the date of the change, as the case may be, to the Registrar who shall record the same.—Sec. 146.

If the situation of the registered office is changed from one place to another within the same town or village, no amendment of the Memo is required but notice must be given to the Registrar.

If the registered office is changed from one city, town, or village to another (within the same State) a special resolution must be passed, and notice must be given to the Registrar.

Failure to comply with the above rules may be punished with fine which may extend to Rs. 50 for every day during which the offence continues.

To change the registered office from one State to another, it is necessary to amend the Memorandum. (See below, under "Alteration of Memorandum").

FORM AND CONTENTS OF THE ARTICLES OF ASSOCIATION

The Articles of Association contain regulations regarding the internal management of companies. An unlimited company, a company limited by guarantee and a private company limited by shares must file their articles of association at the time of registration of the company.—Sec. 26.

A public company may or may not file articles. If it does not, the regulations contained in Table A will apply to it. (Table A is a set of model articles printed in Schedule I to the Companies Act).

The articles of a private company must contain the restrictive features peculiar to private companies (*viz.*, limitation of the number of members to 50; restrictions on the transfer of shares; prohibition of invitation to the public for the purchase of shares and debentures).—Sec. 27(3).

In the case of a company limited by guarantee, the articles shall state the number of members with which the company is to be registered.—Sec. 27(2).

In the case of an unlimited company, the articles shall state the number of members with which the company is to be registered and, if the company has a share capital, the amount of such share capital.—Sec. 27(1).

[Model forms of articles, for use in the case of companies not limited by shares, are given in Schedule I to the Act].

The Articles shall :

- (a) be printed;
- (b) be divided into paragraphs numbered consecutively; and
- (c) be signed by each subscriber of the memorandum of association (who shall add his address, description and occupation, if any), in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.—Sec. 30.

ALTERATION OF THE MEMORANDUM

The Memorandum of Association of a company can be altered by following the procedure laid down in the Companies Act. The procedure is different for different clauses of the memo.

For the purpose of alteration, the provisions of the memo can be divided into two classes : (i) provisions the inclusion of which is made compulsory by the Act (e.g., the name, objects, place of registered office etc.); (ii) other provisions which the organisers of the company have thought it desirable to include.

Provisions coming under the second category can be altered in the same way as provisions of the Articles of Association, (*i.e.*, by special resolution) unless otherwise provided in the Act.

Provisions coming under the first category are called "Conditions contained in the Memorandum". The "conditions" can be altered in the manner stated below :

✓ 1. **Change of Name.** A company may change its name by special resolution provided the Central Government approves of the change.—Sec. 21.

If by inadvertence a company is registered with a name which is identical with or closely resembles the name of an existing company, the name may be changed by an ordinary resolution, with the previous approval of the Central Government. If the company takes no steps in the matter, the Central Government may direct it to change its name within a prescribed period.—Sec. 22.

When the name is validly changed, the Registrar shall enter the new name in the Register of companies and shall issue a fresh Certificate of Incorporation. The Registrar shall also make the necessary alteration in the memorandum of association of the company.—Sec. 23(1) and (2).

Change of name does not affect the rights and obligations of the company and pending suits by or against the company.—Sec. 23(3).

✓ 2. **Change of Object.** (Sections 17-19). The object clause of the memo can be changed for the purpose of enabling the company :

- (a) to carry on its business more economically or more efficiently;
- (b) to attain its main purpose by new or improved means;
- (c) to enlarge or change the local area of its operation;
- (d) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the objects specified in the memorandum;
- (e) to restrict or abandon any of the objects specified in the memorandum;
- (f) to sell or dispose of the whole, or any part of the undertaking, of the company; or
- (g) to amalgamate with any other company or body of persons.

The following procedure must be adopted for changing the object clause :

- (i) A special resolution must be passed.
- (ii) A petition must be filed in Court for confirmation of the change.
- (iii) Notice must be given to all persons whose interests will be affected by the change (unless the Court otherwise directs).
- (iv) The consent of the creditors of the Company must be obtained or their claims paid off or secured.
- (v) Notice must be given to the Registrar of Companies, so that he can appear before the Court and state his objections and suggestions, if any.
- (vi) After the Court has confirmed the alterations, a certified copy of the Court's Order, together with a printed copy of the Memo as altered, shall be filed with the Registrar within 3 months of the date of the order.

The alteration takes effect after it is registered. If no registration is made within 3 months (or such further time as may be allowed by the Court) the alteration and the entire proceedings connected therewith become void. The Court may, on sufficient cause shown, revive the order of alteration on an application made within one month.

Court's Powers : The Court has a wide discretion in allowing changes in the object clause. The Court must take into consideration the rights and interests of the members of the Company and those of its creditors. The Court may allow the change partially or wholly, or may disallow the change. The Court may adjourn the proceedings in order that the Company may purchase the interests of the dissentient members. Orders may be passed for facilitating such arrangements (but no part of the capital of the Company can be spent in any such purchase).

In several cases it has been held that if the proposed changes will radically alter the original objects of the Company, the change will not be allowed. The proposed changes must be for any of the 7 purposes, (a) to (g), mentioned above.

3. Change in the location of the registered office from one State to another. The procedure to be adopted is the same as in the case of alteration of object. See (i) to (vi) above.

The alteration must be registered with the Registrar of Companies of the State in which the registered office of the Company was originally situated and also the Registrar of the State to which the

office is being transferred. The records of the Company will be transferred to the latter place.

✓ 4. **Alteration of the Capital Clause.** Alteration of the Capital Clause, involves increase or reduction of capital and re-organisation of capital. These are discussed in Chapter 4.

ALTERATION OF THE ARTICLES OF ASSOCIATION

The Articles of Association of a Company can be changed by a special resolution. Section 31 of the Act gives to all Companies a statutory right to alter articles and this right cannot be taken away by any provision in the existing articles or the memorandum. A provision, prohibiting change of articles, is not binding on the members.

Although alteration of articles is permitted, there are certain restrictions on the nature and extent of the alterations that can be made.

1. No change is permitted which will violate the provisions of the Companies Act.

2. No change is permitted which is contrary to the conditions contained in the Memorandum of Association of the Company.

3. The alterations must not contain anything illegal.

4. The liability of the members or any class of members, cannot be increased without their consent. *Example* : a member cannot, by altering articles, be made to take more shares or to pay more for the shares already taken, unless he agrees to do so in writing either before or after the alteration. But where the company is a club or association, the articles may be validly altered to provide for subscription or charges at a higher rate.—Sec. 38.

5. Alteration of certain provisions of the articles requires the previous consent of the Central Government (*viz.*, alteration of articles regarding the number of directors and their remuneration; terms of office of Managing Agents and their remuneration; etc.)

6. An alteration of articles which has the effect of converting a public company into a private company shall not have effect unless the alteration is approved by the Central Government.

7. The alteration must not constitute a fraud on the minority. The majority (or the ruling group) must not by altering the articles affect the interests of the minority. The Courts have been given extensive powers to prevent such misuse of power.

But any alteration made *bona fide*, in the interests of the Company as a whole, is valid and binding even though the private interests of some members may be affected.

Example :

In a private limited company, the majority of shares were held by the directors. The articles were altered and the directors were given power to compel members carrying on business in competition with the Company, to sell their shares (at full value) to a nominee of the directors. Held, the alteration was valid. *Sidebottam v. Kershaw*.²

The Court cannot order rectification of articles, even on the ground of mistake. But the court can declare particular clauses to be *ultra vires*. *Scott v. Frank F. Scott Ltd.*³

Articles may be altered with retrospective effect. *Allen v. Gold Reefs Ltd.*⁴

THE LEGAL EFFECTS OF THE MEMORANDUM OF ASSOCIATION

The Memorandum of Association determines the constitution and the powers of the Company.

It was observed by Lord Selbourne that the memorandum is the Company's "fundamental and unalterable law". A Company is incorporated only for the objects and purposes expressed in the memorandum. Any act purported to be done by the Company which is beyond the scope of the functions of the Company as laid down in the memorandum is *ultra vires i.e.* beyond the powers of the Company, and of no effect.

In *Ashbury Railway Carriage & Iron Co. v. Riche*,⁵ a Company was constituted for the purpose of manufacturing railway wagons. The Company purchased the right to run a railway in Belgium. It was held that the purchase was invalid. In this case it was observed that the Memorandum of Association has a twofold effect—an affirmative effect stating what the Company can do and a negative effect indicating what the Company cannot do. "It (the Memo) states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively that nothing shall be done beyond that ambit, and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified". It was also observed in the judgment that, "The directors and share-holders, even if they are unanimous, cannot do things which are not authorised by the memorandum".

² (1920) 1 Ch. 154

³ (1940) Ch. 239

⁴ (1900) 1 Ch. 656

⁵ (1875) 7 H.L. 653

The important rules concerning the legal effects of the memorandum can be summed up as follows :

1. The terms of the memorandum constitute a binding contract between the Company and the members.—Sec. 36.

2. All acts done by the directors or members beyond the powers given in the memo, are *ultra vires* and not binding on the Company.

3. The members cannot ratify *ultra vires* acts, even by an unanimous resolution.

4. If an act is within the powers given by the memo (*intra vires* the memo) but contrary to some provision of the articles (*ultra vires* the articles) the members can change the articles and ratify the act.

5. The object clause in the memorandum is construed like other documents and the Company may do anything which is fairly incidental to and consequential upon the powers specified.

6. If a director makes an *ultra vires* payment (e.g. paying interest out of capital) he can be compelled to refund the money to the Company.

7. Contracts which are *ultra vires* the Company are not binding on the Company. But the aggrieved party can be given relief in certain cases.

Examples :

- (i) If a Company takes an *ultra vires* loan and uses it to pay off a creditor, the second creditor is substituted in the position of the first creditor and can recover the money. *In re Wrexham Rly Co.*⁶
- (ii) If goods are obtained by a Company by an *ultra vires* contract and the goods can be traced in the hands of the Company, the Company can be ordered to return it. *Sinclair v. Brougham.*⁷
- (iii) If money is lent by a Company not having power to lend it, the money can be recovered because the debtor will be estopped from taking the plea that the company had no power to lend. *In re Coltman.*⁸

8. Directors entering into *ultra vires* contracts may be liable to the third party for breach of Warranty of Authority.

9. The memorandum is a public document. Every person dealing with a Company is presumed to know the contents of the memo.

The necessity of drafting the object clause carefully. It is necessary to draft the object clause carefully because the company cannot do anything beyond what is specified in that clause and what can be considered to be fairly incidental or consequential to what is specified there.

⁶ (1899) 1 Ch. 440

⁷ (1914) A.C. 398

⁸ 19 Ch. D. 64

LEGAL EFFECT OF THE ARTICLES

Section 36 of the Act provides that, "subject to the provisions of this Act, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the memorandum and of the articles".

Thus the articles constitute a binding contract between the company and its members. The provisions of the articles can be enforced by suit by the company and the members.

Examples :

- (i) The articles of a company provided that the company will have a first charge on the shares for debts due to the company from the members. A member, owing money to the company, borrowed money from a bank on the security of the shares. Held, the company's claim would have priority because of the provision in the articles. *Bradford Banking Company v. Briggs*.⁰
- (ii) The articles of a company provided that if a member became insolvent, his shares was to be sold to a nominee of the company at a fixed price. Held, the provision was binding and the trustee in bankruptcy cannot claim the share. *Borland, v. Steel Bros*.¹

But if the articles are violated by a member, a suit for the enforcement of the articles can be brought only by the company and not by other members, unless the person against whom relief is sought, controls the majority of shares and will not allow a suit to be brought in the name of the company. *Burland v. Earle*;² *The Dhakeswari Cotton Mills Ltd. v. Nilkamal*.³

The articles come within the definition of public documents. All persons dealing with the company are presumed to know the provisions of the articles. So if anything is done contrary to or beyond the provisions of the articles, the company is not bound.

THE DOCTRINE OF INDOOR MANAGEMENT

When the articles of association of a company prescribe a particular procedure for doing a thing, the duty of carrying out the provisions lies on the persons in charge of the management of the company. Outsiders are entitled to assume that the rules have been complied with. This is known as the Doctrine of Indoor Management.

⁰ 12 A.C. 29

¹ (1901) 1 Ch. 279

² (1902) A.C. 83

³ A.I.R. (1937) Cal. 645

Example :

The articles of a company provided that the directors can give a bond if authorised by a resolution of the company. The directors gave a bond to *T* although no resolution was passed. Held, *T* was entitled to assume that the resolution was passed (because it was a matter of internal procedure) and the company was bound by the bond. *Royal British Bank v. Turquand*.⁴

The doctrine of indoor management does not apply in the following cases :

(a) Where the act is void *ab initio*, the Company is not bound.

Examples :

- (i) An act *ultra vires* the memo or articles cannot bind a company.
- (ii) A share certificate forged by the Secretary of the company and issued under the seal of the company cannot confer any right on the holder thereof.

(b) Where the person dealing with the company has notice, actual or constructive, that the prescribed procedure has not been complied with, the company is not bound.

Example :

X company lends money to Y company on a mortgage of its assets. The procedure laid down in the articles for such transactions was not complied with. The directors of the two companies were the same. Here it may be presumed that the lender had notice of the irregularity. Hence the mortgage is not binding. *Pratt Ltd. v. Sasson & Co. Ltd.*⁵ (facts simplified).

EXERCISES

1. "The memorandum (of association) is the fundamental law or a charter defining the objects and limiting the powers of a company." Explain (C.U. '47; '55).

2. Mention the clauses that a memorandum must contain. Explain the necessity of setting out clearly the 'objects' in the memorandum. To what extent may a company lawfully undertake business and perform acts not expressly set out in the 'objects clause'? (C.U. '56).

3. State the manner in which the provisions of the Memorandum of Association of a Company may be altered. (C.U. '59).

4. In what cases, in what mode and to what extent can a company alter the conditions contained in its Memorandum of Association? (C.A., Nov. '57).

5. Discuss the doctrine of *ultra vires* with reference to the Memorandum of Association of a Limited Company. (C.A., May '59).

⁴ (1856) 6 E & B 327

⁵ 40 Bom L.R. 978

6. Discuss the limits upon the powers of a company to alter or add to the articles of association. (C.A., May '51; Nov. '52).

7. Explain and discuss the rule that persons dealing with a registered company need not enquire into the regularity of the indoor management. (C.A., May '53).

8. State the circumstances in which and the procedure by which a company incorporated under the Companies Act may change its name. (C.A., Nov. '59).

9. Write notes on: Conditions of the Memorandum; Doctrine of Indoor Management.

10. To what extent may a Company lawfully undertake business and perform acts not expressly set out in the object clause of the Memorandum of Association? (C.U., '61).

11. State briefly the circumstances in which and the procedure by which a company may alter the objects clause in its memorandum. (C.A., May '61).

CHAPTER 3

THE FORMATION OF A COMPANY

Before a company can be formed the following steps must be taken :

1. The Memo and the Articles must be prepared.
2. If it is proposed to have a paid up capital of more than Rs. ten lakhs, sanction of the Central Government must be obtained under the Capital Issues (Continuance of Control) Act, 1947.
3. If the company to be formed intends to participate in an industry which is included in the Schedule annexed to the Industries (Development and Regulation) Act, 1951, a licence must be obtained under that Act.
4. The company must be registered in accordance with the provisions of the Companies Act, 1956, and the Certificate of Incorporation must be obtained.

In the case of a public company, the following further steps are required to be taken before it can commence business.

5. The Prospectus or the Statement in lieu of Prospectus must be issued and registered with the Registrar.
6. The minimum subscription must be raised and thereafter the allotment of shares must be made.
7. The Certificate for the Commencement of Business must be obtained from the Registrar.

PROCEDURE FOR THE REGISTRATION OF A COMPANY

For the registration of a company, the following documents, together with the necessary fees, must be submitted to the Registrar of Companies of the State in which the registered office of the company will be situated.—Sec. 33.

1. The Memorandum of Association, prepared in accordance with the provisions of the Companies Act, and signed by at least 7 persons in the case of public companies and 2 persons in the case of private companies.
2. The Articles of Association, in case of unlimited companies, companies limited by guarantee and private companies limited by shares.

3. The agreement with the managing agents of the company, if any, and the agreement, if any, with the body corporate proposed to be appointed as its secretary and treasurer.

4. A declaration by any of the following persons, stating that all the requirements of the Act have been complied with—an advocate, an attorney, a pleader, a chartered accountant, or a person named in the articles as director, managing agent, secretaries and treasurers, manager or secretary of the company.

5. A duly signed list of persons who have consented to be directors of the company, their consent in writing, and the signed agreement with every such director to take the number of shares required to qualify as director.

Documents mentioned under item 5 are not required in the case of private companies and companies not having a share capital.

If the Registrar is satisfied that all the requirements of the Act have been complied with, he will register the company and issue a certificate called the Certificate of Incorporation. The legal existence of the company begins from the date of issue of the Certificate of Incorporation.

The Certificate of Incorporation. The certificate issued by the Registrar after a company is registered is called the Certificate of Incorporation. The Certificate is conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act.—Sec. 35.

Once the Certificate is issued, the incorporation cannot be challenged even though there were irregularities prior to registration.

Examples :

Incorporation was upheld in the following cases—

- (i) Memo materially altered after signature but before registration. *Peel's case*.¹
- (ii) Signatories to the memo all infants. *Moosa v. Ibrahim*.²

PROMOTERS

Definition. The term Promoter is not defined in the Act. Promoter is a word which is used to describe the persons who initially plan the formation of a company and bring it into existence.

“A person who originates a scheme for the formation of the company, has the Memo and the Articles prepared, executed and registered,

¹ (1867) L.R. 2 App. Cases 674

² 40 Cal 1

and finds the first directors, settles the terms of the preliminary contracts and prospectus (if any) and makes arrangements for advertising and circulating the prospectus and placing the capital is a Promoter.”—Palmer, “*Company Precedents*.”

“A person who has not done all these things but has done a substantial part of them so that he may be regarded as having an effective hand in the formation or floatation of the company is also a promoter.”—Sengupta, “*Indian Company Manual*”.

Bowen L. J., in *Whaley v. Green*,³ stated that the term promoter is not a term of law, but of business “usefully summing up in a single word, a number of business operations familiar to the commercial world by which a company is generally brought into existence.”

Sometimes company promotion is undertaken by promoting companies or syndicates formed for the purpose. The rights and liabilities of such companies or syndicates are the same as those of individual promoters. The directors of such companies and members of such syndicates are personally responsible if any breach of trust or fraud is committed.

Promoter's Remuneration. A promoter can take remuneration for his work. The usual methods of taking remuneration are as follows : (i) selling to the company at a profit some property purchased by the promoter before he became one; (ii) taking a commission on the shares sold; (iii) taking a grant of some shares of the company.

The amount of remuneration and the mode of securing it is settled by the promoters themselves and are usually expressed in the prospectus or the memo or the articles.

The Duties and Liabilities of Promoters. The promoter stands in a fiduciary position towards the company. He cannot make any secret profits. He must disclose to the company whatever benefits he personally secures from the formation and floatation of the company. If any secret profit or undisclosed financial benefit is made by the promoter, the company can recover it from him. *Re. Olympia Ltd.*⁴

The promoter is not prohibited from making profits. He can do so, provided he discloses all the facts (including the fact that a profit is being made) to the Board of Directors of the proposed company. If a person purchases some property and later decides to sell it to a company to be formed for using that property, the sale may be made as a profit.

³ 5 Q.B.D. 111

⁴ (1878) 2 Ch. 153

Example :

Five persons bought a mine for £5000 on 1st February 1873. On 4th April, they entered into a contract for the sale of the mine to the trustees of a proposed company for £18,000. It was held that the vendors were not promoters when they bought the mine and, therefore they were under no fiduciary duty to account for the profit they made. *Ladywell Mining Co. v. Brookes*.⁵

A promoter has got certain duties in connection with the prospectus, if any is issued, or the statement in lieu of prospectus. These duties are : (i) he must see that the documents contain the particulars which, according to Schedule II to the Act, they must contain; and (ii) he must see that the documents do not contain any untrue statement. For failure to perform these duties the promoter, (i) is liable to pay compensation to any person who buys shares on the basis of the erroneous prospectus or statement in lieu of prospectus and suffers damage; and (ii) he may be prosecuted in the criminal courts according to the provisions of the Companies Act.

PROSPECTUS

Definition. A prospectus has been defined in the Act as “any document described or issued as a prospectus and includes any notice, circular, advertisement, or other document inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate.”—Sec. 2(36).

Prospectus is the document through which the company secures the capital needed for carrying on its business. Any document having this object, comes within the definition of prospectus. An advertisement for securing business or trade, is not a prospectus.

Form and Contents of the Prospectus. Schedule II to the Companies Act specifies a list of particulars which must be included in the prospectus. The principal items are the following :

- ✓ (i) particulars of signatories of the memorandum of the company and shares subscribed by them;
- ✓ (ii) number and classes of shares and extent of interest of holders and particulars regarding debentures and redeemable preference shares;
- (iii) the rights in respect of capital and dividends attached to different classes of shares;
- ✓ (iv) particulars regarding the directors, managing agents, secretaries and treasurers, etc. and of the contracts fixing the remuneration of managing agents, etc;

- (v) the minimum amount of subscription and amount payable on application;
- (vi) time of opening of subscription list;
- (vii) preliminary expenses incurred;
- (viii) particulars regarding purchase of property;
- (ix) details of any premium or under-writing commissions paid;
- (x) particulars of reserves including reserves capitalised;
- (xi) nature and extent of interest of every director and promoter;
- (xii) names and addresses of the auditors of the company;
- (xiii) in case of existing companies, a report by the auditors showing the profit and loss and assets and liabilities of the company, rates of dividend paid for five years preceding issue of prospectus and particulars regarding subsidiaries;
- (xiv) whether the prospectus is issued at the time of the formation of the company or subsequently.

The prospectus must be dated and this date will be considered to be the date of publication unless otherwise proved.—Sec. 55.

Every application form for shares, issued by the company, must be accompanied by a prospectus containing all the particulars mentioned in Schedule II except application forms issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares and debentures and application forms issued to existing members and debenture-holders.—Sec. 56(3).

A copy of the prospectus, signed by every person mentioned therein as director or proposed director or his agent, must be delivered to the Registrar.—Sec. 60.

A statement, relating to the company, by an expert, can be included in the prospectus only if the expert concerned is not engaged or interested in the formation, promotion, or the management of the company. (Sec. 57). The statement of an expert can be included only if he has, in writing, authorised its issue. (Sec. 58). The term expert includes an engineer, valuer, accountant and any other person whose profession gives authority to a statement made by him.

If the aforesaid rules, relating to the matters to be included in the prospectus, are not complied with, any person who is knowingly a party to the issue thereof, shall be punishable with a fine which may extend to Rs. 5000.—Sec. 59.

A person charged with non-compliance of the aforesaid rules will be excused in the following cases :— [Sec. 56(4)].

(a) as regards any matter not disclosed, if he proves that he had no knowledge thereof; or

(b) if he proves that the non-compliance or contravention arose from an honest mistake of fact on his part; or

(c) if the non-compliance or contravention was in respect of matters which, in the opinion of the Court dealing with the case, was immaterial or was otherwise such as ought in the opinion of that Court, having regard to all the circumstances in the case, reasonably to be excused.

Before a prospectus is issued, it must be registered with the Registrar of Companies. Copies of relevant documents (*e.g.* consent of directors and experts to the issue of the prospectus and copies of contracts) have to be filed when application is made for registration. If the relevant documents are not filed or if the prospectus does not comply with the provisions of the Act, registration will be refused. No prospectus can be issued more than 90 days after a copy of it is filed for registration.—Sec. 60.

The terms of any contract, mentioned in the prospectus, cannot be varied after registration of the prospectus except with the approval of the members in a general meeting.—Sec. 61.

A prospectus issued by a foreign company, with a view to selling shares in India, must include certain additional particulars.—(See Ch. 13).

LIABILITY FOR MISSTATEMENTS IN THE PROSPECTUS

The public invest money in the purchase of shares and debentures of companies on the basis of statements contained in the prospectus. Misstatements and false statements in the prospectus are instruments through which dishonest company promoters may practice fraud on the public. To prevent such practices the law imposes certain duties and liabilities on all persons who are responsible for the issue of the prospectus. One of the duties has already been mentioned, *viz.*, the duty of including in the prospectus, the particulars mentioned in Schedule II to the Act.

Another duty, which the authors of the prospectus have, is to see that the prospectus contains no untrue statement likely to mislead the public. Section 65 of the Companies Act lays down that the term “untrue statement” in connection with a prospectus shall be deemed to include :

(a) a statement which is misleading in the form and context in which it is included, and

(b) an omission (of any matter) which is calculated to mislead.

Thus, the term untrue statement or misstatement, is used in a wide sense. It includes not only false statements but also statements which

produce a wrong impression of actual facts. Concealment of a material fact also comes within the category of misstatement.

Persons liable for untrue statements in the prospectus. Section 62(1) of the Act provides that the following persons are liable (or punishable) for untrue statements in the prospectus :

(a) every person who is a director of the company at the time of the issue of the prospectus;

(b) every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of time;

(c) every person who is a promoter of the company; and

(d) every person who has authorised the issue of the prospectus.

The extent of the liability for untrue statements. The Companies Act imposes a two-fold liability on the persons responsible for untrue statements in the prospectus—a civil liability and a criminal liability.

Section 62 (1) provides that such persons are liable to pay compensation for any loss or damage which any person may suffer from the purchase of any share or debenture on the basis of the untrue statement.

A person who has been made to pay compensation under this section can claim contribution from the others who were associated with him in the issue of the prospectus, unless it appears that he was guilty of fraud while the others were not.

Section 63(1) provides that every person who has authorised the issue of a prospectus containing untrue statements, shall be punishable with imprisonment which may extend to two years or with fine which may extend to Rs. 5000, or both.

A person who has suffered damage by purchasing shares or debentures on the basis of untrue statements in the prospectus may, instead of proceeding under Section 62(1) of the Companies Act, take action under the general law of fraud. The law relating to fraud provides that when a person is induced to enter into a contract by fraud, he is entitled to rescind the contract and to get compensation for the loss or damage which he may have suffered. The aggrieved shareholder or debenture holder may base his suit on this cause of action. *Derry v. Peek*^a.

Defences available in an action on the prospectus. The parties against whom proceedings have been initiated for untrue statements in the prospectus are allowed to use certain pleas in their defence.

^a 14 A.C. 337

1. *Defence against the civil liability imposed by Sec. 62(1).* Section 62(2) provides that no decree for damages will be passed if the person charged can prove any of the following :

(a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

(c) that, after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statement therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and of the reason therefor; or

(d) that

(i) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, as the case may be, believe, that the statement was true; and

(ii) as regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy of or extract from a report or valuation of an expert it was a correct and fair representation of the statement or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe, and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that, that person had given the consent required by Section 58 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder; and

(iii) as regards every untrue statement, purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement or a correct copy of, or a correct and fair extract from, the document.

2. *Defences available to an expert.* An "expert" whose opinion was included in the prospectus, can use the following defences : [Sec. 62 (4).]

(a) that having given his consent under Section 58 to the issue

of the prospectus, he withdrew it in writing before delivery of a copy of the prospectus for registration; or

✓ (b) that, after delivery of a copy of the prospectus for registration and before allotment thereunder, he, on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal, and of the reason therefor; or

(c) that he was competent to make the statement and that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, believe, that the statement was true.

3. *Defences against criminal liability.* A person charged in a criminal court under Section 63(1) will be acquitted if he can prove either of the following :

(a) that the statement was immaterial, or

✓ (b) that he had reasonable ground to believe, and did, up to the time of the issue of the prospectus, believe that the statement was true.

Certain other cases where the purchaser of shares has no remedy.

There have been a large number of cases in English courts regarding the prospectus and the shareholders' rights thereon. It has been held that the shareholder has no rights, either to damages or to rescission of the contract of purchase, in the following cases :

(i) A person who has *not* purchased the shares on the basis of the prospectus, is not entitled to any remedy. A person who has purchased shares from an existing shareholder cannot be said to have purchased the shares on the basis of the prospectus, and is not entitled to any relief if there are untrue statements in the prospectus. *Peek v. Guiney*.¹

(ii) The statement complained of must come within the definition of untrue statement. A mere expression of opinion or expectation gives no ground of action. *Karberg's case*.²

(iii) If the shareholder does any act which amounts to confirmation of the purchase (e.g. if he accepts dividends) the right to rescind the contract or get damages is lost.

(iv) The shareholder must bring his action without undue delay, otherwise he loses his rights.

STATEMENT IN LIEU OF PROSPECTUS

A public company having a share capital and not issuing a pros-

¹ 6 H.L. 337

² (1892) 3 Ch. 1

pectus must within at least 3 days of allotting shares to the applicants thereof, file with the Registrar for registration *a statement in lieu of prospectus*. The statement must be in the form prescribed in Schedule III to the Act. The prescribed form provides for the disclosure of all material facts relating to the company.—Sec. 70(1).

If the statement in lieu of prospectus contains any untrue statement, the persons responsible for the issue thereof may be punished by imprisonment which may extend to 2 years or with fine which may extend to Rs. 5,000 or with both.—Sec. 70(5).

PROSPECTUS BY IMPLICATION

Section 64 provides that certain documents are to be included within the term Prospectus by implication of law. Where a company allots or agrees to allot any shares in or debentures of the company with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made, is deemed to be a prospectus issued by the company.

Subject to the modifications stated below, all the rules laid down in the Act, regarding prospectuses (contents, liability for misstatements etc.) apply also to a prospectus by implication.

1. The following additional matters must be stated in it : the net amount of consideration to be received by the company in respect of the shares or debentures; and the place and time at which the contract (under which the shares or debentures are to be allotted) may be inspected.

2. The persons making the offer of sale to the public are to be deemed directors of the company for the purpose of registration of the prospectus.

3. Where the person making the offer is a company, the prospectus may be signed by any two directors; where the offer is made by a firm, it may be signed by not less than one-half of the partners.

Unless the contrary is shown, an allotment or agreement to allot shares or debentures will be deemed to have been made with a view to sale to public, under the following circumstances :

1. When the offer for sale was made within six months after the allotment or agreement to allot.

2. When at the date of the offer for sale, the whole consideration to be received by the company for the shares or debentures had not been received by it.

MINIMUM SUBSCRIPTION

Where shares are offered to the public for subscription, the prospectus must mention the minimum amount which must be raised by the issue of shares before the company can commence business.—Schedule II, clause 5.

The minimum subscription is to be fixed by the directors or by the persons who have signed the memorandum. Its amount is to be determined by taking into account the following expenses :

- (i) the purchase price of any necessary property ;
- (ii) the preliminary expenses, including commissions payable for the sale of shares ;
- (iii) repayment of any moneys borrowed by the company for the above two purposes ;
- (iv) working capital ;
- (v) any other necessary expenditure.

The amount stated in the prospectus as minimum subscription, is to be reckoned exclusively of any amount payable otherwise than in money.

Shares cannot be allotted until applications have been received sufficient to cover the minimum subscription.

ALLOTMENT OF SHARES

The prospectus is an invitation to the public to purchase shares. Persons intending to purchase shares have to apply in a form prescribed in the prospectus for the purpose and called the “application form”. The prospectus also fixes the time when the applications will be opened and the allotment of shares to the applicants will be made. The time is known as “the time of opening of the subscription lists”. Applicants to whom shares have been allotted are informed by a letter. This letter is called, “the notice of allotment.”

Membership of a company by purchase of shares is the result of a contract. ‘The application by the intending shareholder is the offer for the purchase of shares. Allotment by the directors is the acceptance of the offer.’ ‘The notice of allotment is the communication of the acceptance.’ Each of these stages in the formation of the contract must conform to the rules laid down in the Contract Act.

The allotment must be made within a reasonable time, otherwise the applicant is not bound to take the shares. The offer to buy the shares is deemed to be revoked if there is an unreasonable delay

in accepting the offer. *Ramsgate Victoria Hotel Co. v. Montefiore*,⁹ *Indian Co-operative Navigation v. Padamsey*.¹

Conditions regarding the acceptance of the offer to purchase shares, are usually printed on the application form. One very common condition is that in case of over-subscription, the number of shares allotted to each subscriber will be proportionately less than the number of shares applied for.

The Companies Act prescribes the following restrictions on the allotment of shares :

1. No allotment can be made until the beginning of the 5th day after the publication of the prospectus or such later time as may be prescribed for the purpose in the prospectus. (Sec. 72). The 5th day is to be counted from the date when the prospectus was published in a newspaper or was otherwise notified to the public.

The object of this rule is to provide sufficient time to the public to send the applications. An application for shares cannot be revoked until after the expiration of the 5th day *after* the time of opening of the subscription lists, except in one case. If any of the persons responsible for the issue of the prospectus, gives public notice of withdrawal of his consent to the issue of the prospectus, any of the applicants can revoke his application, whereupon no shares can be allotted to him.

An allotment of shares prior to the time prescribed under this rule is not void. But the directors making such allotment are liable to punishment.

2. No allotment can be made until the amount fixed as the minimum subscription has been received.—Sec. 69(1).

3. The amount payable on each share, with the application form, shall not be less than 5 per cent of the nominal value of the share.—Sec. 69(3).

4. All moneys received from the applicants must be kept in deposit in a scheduled bank until the certificate to commence business has been obtained or until the money is refunded to the applicants.—Sec. 69(4).

5. If the minimum subscription is not raised or if, for any other reason, allotment could not be made within 120 days from the date of publication of the prospectus, the directors must forthwith return the moneys received from the applicants. No interest is payable if the money is refunded within 130 days. Thereafter, the directors are, jointly and severally, liable to pay interest at 6 per cent per

⁹ (1866) L.R. 1 Ex. 109 .

¹ 36 Bom. L.R. 32

annum from the 130th day to the day of repayment. But a director shall not be so liable if he proves that the default in the repayment of the money was not due to misconduct or negligence on his part.—Sec. 69(5).

6. A public company which has not issued any prospectus must, at least 3 days before the first allotment of shares, deliver to the Registrar for registration, a Statement in lieu of Prospectus, signed by every director or proposed director or his agent in the form prescribed in Schedule III to the Act.—Sec. 70.

7. *Stock Exchange recognition.* Where the prospectus states that application has been made or will be made for the shares (or debentures) being dealt with in a recognised stock exchange, the application necessary for securing permission of the authorities of the stock exchange must be made before the 10th day after the first issue of the prospectus. Any allotment, made on an application based on such a prospectus, becomes void if stock exchange permission is not applied for or if such permission is not granted within 4 weeks from the date of the closing of the subscription lists or such longer period not exceeding 7 weeks as may, within the said 4 weeks, be notified by the stock exchange. The company must thereupon return all moneys received from the applicants of shares. No interest is payable if the moneys are returned within 8 days. Thereafter, interest is payable at 5%.—Sec. 73.

Effects of an irregular allotment: An allotment made in violation of sections 69 and 70 (summarised in rules 1 to 6 above) has the following consequences :

1. The allotment becomes voidable at the option of the shareholder. The option, to avoid the contract, must be exercised within 2 months of the holding of the statutory meeting or, where no statutory meeting is required to be held or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment. The option to avoid can be exercised even if the company is in course of liquidation.—Sec. 71(1) and (2).

2. Any director knowingly or wilfully contravening the rules or authorising the contravention, shall be liable to pay compensation to the shareholders concerned for any loss or damage suffered. The suit for compensation must be brought within 2 years of the date of allotment.—Sec. 71(3).

Any allotment made in violation of Section 73 is void.

THE RETURN AS TO ALLOTMENT

Whenever a company having a share capital makes any allotment of its shares, it must within one month thereafter file with the Registrar a return of the allotment, giving full particulars of the allotment made.—Sec. 75.

RESTRICTIONS ON THE COMMENCEMENT
OF BUSINESS

A public company, having a share capital and *issuing a prospectus*, cannot commence business until the Registrar issues a certificate known as the "Certificate of Commencement of Business". This certificate is issued after the following formalities have been complied with.—Sec. 149(1) :

- (a) The minimum subscription has been raised.
- (b) Every director has paid the moneys payable, on application and on allotment, for the shares taken up by him.
- (c) No money is repayable for failure to obtain stock exchange recognition for the shares, where such recognition was promised.
- (d) A duly verified declaration by a director or the secretary has been filed with the Registrar stating that the above requirements have been complied with.

A public company having a share capital but *not issuing a prospectus*, will get the commencement certificate if the following conditions are satisfied.—Sec. 149(2) :

- (a) A statement in lieu of prospectus has been filed with the Registrar.
- (b) The directors have paid the moneys due from them on account of shares.
- (c) A declaration by a director or the secretary has been filed with the Registrar stating that condition (b) has been satisfied.

If any company commences business in contravention of these rules, every person responsible shall be punishable with a fine which may extend to Rs. 500 for every day during which the contravention continues.

A company may enter into contracts before the date of commencement of business but such contracts remain provisional up to the commencement date and become binding on that date.

The restrictions on the commencement of business do not apply to private companies.

EXERCISES

1. Set out clearly the different stages or steps in the formation of a limited liability company from promotion to commencement of business. (C.U. '55)
2. What steps are to be taken for the formation and commencement of a company? (C.U. B.Com. '62)
3. What is the meaning of "promoter of a company"? Explain briefly his liabilities. (C.A., May '51, '54)
4. What is the Prospectus of a Company? Mention its principal contents. What is the effect of misrepresentation in the prospectus? (C.U. '60)
5. Discuss fully the question of liability for statements made in the prospectus. (C.A., May '55)
6. Discuss the provisions relating to allotment of shares under the Companies Act. (C.A., May '59)
7. When is a public company entitled to proceed to allot its shares? What is an irregular allotment? What are the consequences of an irregular allotment? (C.A., Nov. '60)
8. What is minimum subscription? In what case is minimum subscription necessary and what are the consequences of its not being subscribed? (C.A., Nov. '51)
9. Write notes on—Statement in lieu of Prospectus; Allotment of Shares; Certificate of Incorporation; Certificate of Commencement (C.U. '60); Return of Allotment; Opening of the Subscription List.

CHAPTER 4

CAPITAL, SHARES AND SHAREHOLDERS

CAPITAL

The term “capital” used in connection with company formation, may mean any one of the following three things :

1. **Nominal or Authorised Capital.** This means the total face value of the shares which the company is authorised to issue by its memorandum of association.

2. **Issued or Subscribed Capital.** This means the total face value of the shares actually subscribed for and issued.

3. **Paid up Capital.** This means the amount of money actually paid by the subscribers or credited as so paid.

The full authorised capital may not be needed by a company at the time it commences business. A company may issue less than the authorised capital, reserving the right to raise further moneys by the sale of the unissued shares at a later time. The mode of payment of the value of the shares is laid down in the articles. At least 5 per cent is payable with the application for the shares. The balance may be payable in full upon allotment or may be payable by instalments or according to calls made by the directors.

SHARES

The shareholders are the proprietors of the company. Therefore, a “Share” may be defined as an interest in the company entitling the owner thereof to receive a proportionate part of the profits, if any, and of a proportionate part of the assets of the company upon liquidation.

“A share is not a sum of money, but is an interest measured in a sum of money, and made up of various rights, contained in the contract.”—Farwell J. in *Borland v. Steel Bros. & Co.*¹

The shares or other interest of any member in a company is movable property, transferable in the manner provided by the articles of the company.—Sec. 82.

¹ (1901) 1 Ch. 226

The shares must be numbered so as to distinguish them from one another.—Sec. 83.

Classification of Shares. Under the Companies Act of 1913 many kinds of shares could be issued and accordingly there were many kinds of shareholders. The rights and liabilities of each class of shareholders were laid down in the articles, subject to the provisions of the Companies Act.

Shares issued *prior to* the Companies Act of 1956 can be classified into three types as follows :

1. *Ordinary Shares.* Ordinary shares are shares without any special privileges.

2. *Preference Shares.* Preference shares are shares which are in a privileged position as regards the payment of dividends and other matters specified in the articles.

3. *Deferred Shares.* Deferred shares are shares granted to the founders of the company as remuneration for their services. The rights of deferred shareholders are usually limited by the articles.

There are many varieties of each of the aforesaid types of shares.

The Companies Act of 1956 provides that after the commencement of the Act, there can be only *two types* of share capital, viz.

(a) Equity Share Capital, and

(b) Preference Share Capital.

Preference Share Capital. Preference share capital has been defined in Section 85, as that part of the share capital of a company which enjoys a preferential right as regards the payment of dividends and as regards the return of the amount paid up on the share, upon wind-up of the company.

To be classed as a preference share, a share must be given by the articles the two privileges mentioned above, viz. (i) priority in the payment of dividends over other shares and (ii) priority as regards return of the capital paid up on the share, in the event of liquidation.

The holder of a preference share is entitled to receive dividend (at rates fixed by the articles) before any dividend is declared on the other shares. A preference share may be *Cumulative or Non-Cumulative*. In the case of cumulative preference shares, if the profit made by the company in a particular year is not sufficient to pay dividend at the prescribed rate, the shortage must be made up out of the profits of succeeding years. The dividends accumulate. In non-cumulative preference shares any such shortage is not required to be made up. Dividends which are not paid, do not accumulate but lapse.

In the event of winding up, if surplus assets are available, the preference shareholders must first be given back the amount which they paid on the share. The balance is available for distribution to the other shareholders.

In addition to the two privileges mentioned above, the articles may give other privileges to the holders of preference shares. For example, they may be given the right to share in surplus profits beyond the amount or rate prescribed for them, if such surplus profits are available. Sometimes preference shareholders are given the right to share in the surplus assets upon liquidation if any assets are available. Prior to the Act of 1956, preference shareholders were given additional voting powers but now it cannot be done.

A preference share may be *redeemable* or *irredeemable*. The former could be redeemed *i.e.* purchased back by the company, subject to the conditions laid down in the articles and in the Act. An irredeemable preference share is one which cannot be purchased back.

Equity Share Capital. Share capital other than preference share capital is called Equity Share Capital. The rights and privileges of equity shareholders are laid down in the articles, subject to the provisions of the Act. The Companies Act of 1956 provides that in public companies only equity shareholders shall have the right to vote on all resolutions placed before the members. This right cannot be curtailed by the articles.

VOTING RIGHT OF SHAREHOLDERS

An equity shareholder is entitled to vote on every resolution placed before the company. The number of votes he can cast is proportional to his share of the paid up equity capital of the company.—Sec. 87(1).

A preference shareholder is entitled to vote only on resolutions which directly affect the rights attached to his preference shares and resolutions for the winding up of the company. But if the dividend due on such capital or any part of it remains unpaid, the preference shareholders become entitled to vote on every resolution.—Sec. 87(2).

The number of votes which a preference shareholder can cast, shall be in the same proportion as the capital paid up in respect of the preference shares bears to the total paid up equity capital of the company.—Sec. 87(3).

After the commencement of the Act of 1956, no equity shares can be issued with voting rights in excess of those mentioned above.—Sec. 88.

Excessive voting rights in existing companies are to be reduced within one year. But the Central Government may exempt any company from the operation of this rule.—Sec. 89.

The rules regarding voting rights, stated above, do not apply to private companies, other than private companies which are subsidiaries of public companies.—Sec. 90.

REDEEMABLE PREFERENCE SHARES

Section 80 of the Act provides that a company limited by shares may, if so authorised by the articles, issue preference shares which are, or at the option of the company are, liable to be redeemed. It is also provided that,

(a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of the redemption;

(b) no such shares shall be redeemed unless they are fully paid;

(c) the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's share premium account;

(d) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue of shares, there shall be transferred to an account, to be called "the capital redemption reserve account", a sum equal to the nominal amount of the shares redeemed.

Subject to the aforesaid rules, the redemption of preference shares may be effected on such terms and in such manner as may be provided by the articles of the company.

The redemption of preference shares under Section 80 of the Act, shall not be taken as reducing the amount of the authorised share capital of the company.

Where in accordance with the aforesaid provisions, a company has redeemed or is about to redeem any preference shares it shall have power to issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued. The issue of such new shares shall not be taken into account for the purpose of calculating the fees payable under Section 611, if the old shares are redeemed within one month after the issue of the new shares.

The capital redemption reserve account may be applied by the

company, in paying up un-issued shares of the company, to be issued to members of the company as fully paid bonus shares.

FURTHER ISSUE OF CAPITAL

After the formation of a company, further shares may be issued. The rules regarding such issues are as follows.—Sec. 81(1).

Where at any time the expiry of two years from the formation of a company or at any time after one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital of the company by allotment of further shares, the following procedure must be adopted.

(a) Such new shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company in proportion as nearly as circumstances admit, to the capital paid up on those shares at that date.

(b) The offer aforesaid shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days from the date of the offer within which the offer if not accepted, will be deemed to have been declined.

(c) The offeree of the shares may renounce the offer in favour of any other person, unless the articles of the company provide otherwise.

(d) After the expiry of the time specified in the notice aforesaid or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner as they think most beneficial to the company.

Shares, issued under this Section are called “Rights” shares.

Exceptions :

1. Section 81 (1A) added by the amending Act of 1960 provides that further shares may be offered to any person in any manner whatsoever in the following cases :

(a) if a special resolution to that effect is passed by the company in general meeting; or

(b) if a proposal to that effect is passed by the majority of members in a general meeting *and* the Central Government is satisfied that the proposal is most beneficial to the company.

2. Section 81(3) provides that the rules contained in Section 81(1) shall not apply,

(a) to a private company; or

(b) where the subscribed capital of a public company is increased

because debenture holders or creditors were given an option (by a special resolution passed by the company in general meeting and approved by the Central Government) to convert the debentures or loans into shares of the company.

SHARE CERTIFICATE

The share certificate is a certificate issued under the common seal of the company specifying the number of shares held by any member. A company must prepare the share certificates and have them ready for delivery, within two months of the allotment of shares and/or registration of any transfer of shares, unless the conditions of the issue of the shares provide otherwise.—Sec. 113.

The share certificate is *prima facie* evidence of the title of the member of such shares.—Sec. 84(1).

A certificate may be renewed or a duplicate issued if it (a) is proved to have been lost or destroyed, or (b) having been defaced or mutilated or torn is surrendered to the company.—Sec. 84(2).

If a company renews a certificate or issues a duplicate with intent to defraud, it shall be punished with a fine and every officer in default shall be punished with a fine or imprisonment.—Sec. 84(3).

The Government may prescribe rules regarding the issue, renewal etc. of share certificates.—Sec. 84(4).

A share certificate issued by persons authorised by the company, binds the company, in certain ways.

Examples :

- (i) The company cannot deny the title of the certificate holder. *Dixon v. Kennaway*.²
- (ii) If the certificate states that the shares are fully paid up, the company cannot plead that they are not so. *Bloomenthal v. Ford*.³

SHARE WARRANT

A share warrant is a document issued by a company, stating that its bearer is entitled to the shares therein specified. It is a substitute for the share certificate. Share warrants may be issued for fully paid up shares, if the articles so provide and if the approval of the Central Government has been obtained. A share warrant may have attached coupons on the production of which the dividends due on the shares will be paid. Shares may be transferred by delivery of the warrant.—Sec. 114.

When a share warrant is issued, the name of the holder of the share certificate concerned shall be removed from the Register of

² (1900) 1 Ch. 833

³ (1897) A C. 156

Members and the number and date of the share warrant shall be noted there. Any holder of the warrant can, if he so desires, surrender the warrant and take a share certificate, whereupon his name shall be recorded in the Register of Members. The holder of a share warrant does not ordinarily possess the right to vote and exercise other rights of membership, but the articles may give him that right.—Sec. 115.

STOCK

When all the shares of a company have been fully paid up, they may be converted into stock if so authorised by the articles.—Sec. 94 (1) (c).

Conversion into stock is made because it is a convenient method of denoting the capital of the company and the interests of the members. It does not affect the rights of the members in any way.

Shares are of equal amounts and cannot be issued in fragments. A member cannot hold $\frac{1}{2}$ a share. Stock may be divided into unequal amounts and subdivision is possible. Thus Rs. 100 worth of stock can be divided into two parts of Rs. 50 each.

When shares are converted into stock, notice must be given to the Registrar. The register of members must thereafter show the amount of stock held by each member instead of the amount of shares.—Sec. 150.

The provisions of the Act relating to shares only, cease to apply to shares which have been converted into stock.—Sec. 96.

“The use of the term ‘stock’ merely denotes that the company have recognised the fact of the complete payment of the shares, and that the time has come when these shares may be assigned in fragments, which for obvious reasons could not be permitted before.”—*Per Lord Cairns in Marrice v. Aylmer*.⁴

RESERVE CAPITAL

A limited company may by special resolution determine that any portion of its share capital which has not been called up, shall not be called up, except in the event of the company being wound up.—Sec. 99.

The uncalled capital, freed from call in the manner aforesaid, is called the Reserve Capital of the company. The company cannot charge the reserve capital for raising a loan, nor can it be dealt with in any way except on liquidation.

⁴ (1874) 10 Ch. App. 148

ALTERATION OF SHARE CAPITAL

Section 94 of the Act provides that a company may, if so authorised by the articles, alter its share capital in any one of the following ways :

(a) increase its share capital by such amount as it thinks expedient by issuing new shares;

(b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;

(c) convert all or any of its fully paid up shares into stock, and reconvert stock into fully paid up shares of any denomination;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Alterations, coming within the aforesaid categories, can be made by a company by resolution passed in a general meeting. Confirmation by the court is not necessary. Cancellation of shares under this section [item (e) above] is not deemed to be a reduction of share capital. Notice of any alteration made under this Section must be given to the Registrar within one month of the alteration.

REDUCTION OF SHARE CAPITAL

A company may find it necessary to reduce its share capital for various reasons. Reduction of share-capital may be made for any one or more of the following purposes: (a) to extinguish or reduce the liability of the shareholders as regards the uncalled capital; (b) to cancel any paid up share capital which is lost or is unrepresented by available assets; and (c) to pay off any paid up share capital which is in excess of the wants of the company.

Procedure for reducing share capital. A company can reduce its share capital for any purpose, including those mentioned above, provided the following requirements are complied with.—Sections 100-105.

1. Reduction of capital must be authorised by the articles. If the existing articles do not give that power, they may be amended.

2. A special resolution must be passed.

3. Sanction of the court must be obtained.

The court, may, before giving sanction to the reduction, direct the issue of notices to all creditors of the company, whose claims are of such a nature that they are provable upon winding up. The court is to settle the list of creditors for this purpose. After hearing the objections of the creditors, if any, the court may direct that before reduction of capital is allowed, the claims of the creditors must be either paid up or secured.

The court may order that for a specified period after the reduction, the company shall add the words "and reduced" at the end of its name.

The court may also order the publication of the reasons which led the company to reduce its capital, so that the public may be informed.

4. A certified copy of the Court's order and a minute approved by the Court showing what has been done, must be filed with the Registrar for registration. The reduction takes effect from the date of registration.

After reduction, the liability of the shareholders becomes as ordered by the court and as recorded in the minute of reduction. But if there is a creditor who was ignorant of the proceedings for reduction and if the company is unable to pay his claim, all shareholders whose liabilities were reduced will be bound to contribute towards the claim of the creditor to the same extent as they would have had to, had there been no reduction. This rule applies in case of winding up also.

Officers of the company, who conceal the name of any creditor entitled to object, are punishable with imprisonment up to one year or with fine.

VARIATION OF SHAREHOLDERS' RIGHTS

The rights given by the memorandum and the articles to the different classes of shareholders may be varied if the following requirements are fulfilled.—Sections 106, 107.

1. There must be provision in the memorandum or the articles for such variation, or (in the absence of any such provision in the memorandum or articles) if such variation is not prohibited by the terms of issue of the shares of that class.

2. The variation must be agreed to by the holders of any specified proportion, not less than $\frac{3}{4}$ ths., of the issued shares of that class. Specified means specified in the memo or the articles. The consent may be given by a resolution passed in a meeting of the holders of that class of shareholders or otherwise.

The variation may be challenged in court by an application made by at least 10% of the aggregate number of holders of that class of shares. They must be persons who did not vote for the resolution for variation. The application must be made within 21 days of the resolution or consent. If the court is of opinion that the variation is of such a nature as would unfairly prejudice the rights of that class of shareholders, the court may disallow the variation. The decision of the court is final. The order of the court must be communicated to the Registrar by the company.

ISSUE OF SHARES AT A PREMIUM

A company may issue shares as a premium, *i.e.*, at a value greater than its face value. If it does so, it must transfer an amount equal to the aggregate value of the premium received to an account to be called, "the share premium account". The share premium account may be applied by the company for any of the following purposes : (Sec. 78).

(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

Except for the purposes mentioned above, the share premium is to be considered part of the capital of the company. The provisions of the Act relating to reduction of capital are applicable to the share premium.

ISSUE OF SHARES AT A DISCOUNT

A company can issue shares at a discount, *i.e.*, at a value less than its face value, provided the following conditions are fulfilled (Sec. 79).

(a) the issue of the shares at a discount is authorised by a resolution passed by the company in general meeting, and sanctioned by the Court;

(b) the resolution specifies the maximum rate of discount (not exceeding ten per cent or such higher percentage as the Central Government may permit in any special case) at which the shares are to be issued;

(c) not less than one year has, at the date of the issue, elapsed since the date on which the company was entitled to commence business; and

(d) the shares to be issued at a discount are issued within two months after the date on which the issue is sanctioned by the Court or within such extended time as the Court may allow.

Every prospectus, relating to the issue of shares, shall contain particulars of the discount allowed and so much of the discount as has not been written off.

COMMISSION AND BROKERAGE

A company can pay commission to a person subscribing to the shares or (debentures) or procuring subscriptions for them, provided the following conditions are fulfilled.—Sec. 76.

1. The payment must be authorised by the articles.

2. The rate of commission must not exceed in the case of shares : 5% of the issue price or the rate prescribed in the articles, whichever is less; and in the case of debentures : $2\frac{1}{2}\%$ of the issue price or the rate prescribed in the articles, whichever is less.

3. The amount or rate of commission payable, and the number of shares and debentures which have been agreed to be subscribed at a commission must be disclosed in the prospectus or statement in lieu of prospectus.

The above rules do not apply to brokerage paid for the sale of shares or debentures. A company is free to pay such brokerage "as it has heretofore been lawful to pay".—Sec. 76(3).

PURCHASE OF THE COMPANY'S OWN SHARE

A company limited by shares or by guarantee cannot purchase its own shares because such a purchase amounts to a reduction of capital —Sec. 77(1).

No public company and no private company which is a subsidiary of a public company can give by loan or otherwise any financial

assistance for the purchase of its own shares or the shares of its holding company.—Sec. 77(2).

The rule that a company cannot purchase its own shares, is subject to the following exceptions :

1. A company may purchase its own shares if the consequent reduction of capital is effected and sanctioned in accordance with the rules prescribed in the Act for reduction of capital.

2. A company can redeem its redeemable preference shares where it can lawfully do so.

3. This rule does not prevent forfeiture or surrender of shares where lawfully made.

4. The court can direct purchase of shares under Section 402 when necessary for the protection of the interests of the minority.

The rule that a company cannot finance the purchase of its own shares [Sec. 77(2)] does not imply a prohibition of the following types of transactions :

(a) the lending of money by a banking company in the ordinary course of its business :

(b) the provision of money, in accordance with a scheme for the time being in force, for the purchase of fully paid up shares in the company or its holding company, by trustees of employees or for the benefit of employees (the term employee includes a director holding a salaried employment under the company); and

(c) the making of loans to employees (not exceeding 6 months' wages) for the purpose of purchasing shares in the company or its holding company. (This clause does not apply to loans to directors, managing agents, secretaries and treasures, and managers.)

THE REGISTER AND INDEX OF MEMBERS

Every company is bound to keep a Register of Members in which particulars are entered regarding the name, address, and occupation of the members; the number of shares held by each; the date of commencement and cessation of membership; and similar particulars regarding ownership of stock, where the shares have been converted into stock.—Sec. 150.

Every company having more than 50 members, shall keep an Index of Members, unless the Register of Members is kept in the form of an index.—Sec. 151.

No notice of any trust, express, implied or constructive, shall be entered in the Register of Members.—Sec. 153.

A company may after giving not less than 7 days' notice by advertisement in some local newspaper, close the Register of Members for a period of not more than 45 days in the year and not more than 30 days at a time.—Sec. 154.

Rectification of the Register of Members. (Sec. 155). The Court may issue orders for the rectification of the Register of Members if,

- (a) the name of any member is, without sufficient cause, entered in the Register; or after having been entered in the Register, is, without sufficient cause, omitted therefrom; or
- (b) default is made, or unnecessary delay takes place, in entering on the Register, the fact of any person having become or ceased to be, a member.

The court may direct the company to pay damages, if any, sustained by any party aggrieved.

The Court has power to rectify the Register of Debenture holders under circumstances similar to those stated above.

The Registrar must be informed whenever the Register of shareholders or debenture holders is rectified.—Sec. 156.

The Foreign Register. A company may, if so authorised by the articles, keep in a country outside India, a branch Register of members resident in that country. Such a register is called the Foreign Register. A duplicate of the Foreign Register must be kept in India and a copy of all changes made in the entries must be transmitted to the registered office in India.—Sections 157, 158.

MEMBERSHIP OF A COMPANY

Definition of "Member". According to Section 41 of the Act, the term "member" of a company means,

- (1) the subscribers of the memorandum of the company, and
- (2) every other person who agrees in writing to become a member of a company and whose name is entered in its register of members.

How is membership created ? A person can become member of a company in any one of the following ways :

- 1. By signing the memorandum of association before it is presented for registration.
- 2. By getting an allotment of shares and having his name included in the register of members.

3. By getting a transfer of shares from an existing member and having the transfer recognised by the company.

4. By obtaining shares by inheritance from a deceased member and getting his name included in the register of members.

5. By allowing his name to remain in the register of members under such circumstances that he cannot later on plead that he is not a member.

Transfer and Transmission of shares. When shares pass from one person to another by a voluntary act, *e.g.* by sale, gift or otherwise, it is called transfer. When shares pass by operation of law from one person to another, *e.g.* by inheritance, it is called transmission.

Who can be a member ? The Companies Act does not prescribe any qualification for membership of a company. But since membership is created by agreement, it may be argued that persons incapable of entering into contracts cannot be members.

The case of a minor : An agreement by a minor is void in India. Therefore a minor cannot apply for and be a member of a company. If a minor has, by mistake, been recorded as a member, the company can rescind the transaction and remove the name from the register. The minor can also repudiate the transaction and get his name removed from the register. But where a minor was made a member and, after attaining majority, he received and accepted dividends, he will be estopped from denying that he is a member. *Fazalbhoy v. The Credit Bank of India.*⁵

The case of a company : A company can be a member of a company. But a subsidiary company cannot be a member of its holding company, except where the subsidiary company comes in as the legal representative of a deceased member.—Sec. 42.

Other cases : A person to whom shares have been transferred by way of security, becomes a member of the company and is liable as such.

A person who purchases shares in the name of a fictitious person is liable as a member. *Re. Klondyke Gold Co.*⁶

A trustee, as a trustee, cannot be a member because a company will not register notice of any trust. A trustee who buys shares will be treated as a member in his individual capacity.

How membership ceases : The membership of a person in a company may terminate in any one of the following ways :

⁵ 39 Bom 331

⁶ (1809) W. N. 1

1. By death. When a member dies the ownership of the shares passes to his successors. The successors will, on production of evidence of ownership be registered as members in place of the deceased member. But a company may have, under the articles, a right to refuse to recognise the successors as members.

2. By insolvency. Upon insolvency of a member, the shares vest in the official assignee or the official receiver.

3. By rescission of the contract to purchase shares. A person who has purchased shares may under certain circumstances have the contract rescinded *e.g.* when there are untrue statements in the prospectus. Upon rescission he ceases to be a member.

4. By forfeiture of the shares, according to the provisions of the articles.

5. By a surrender of the shares, where surrender is permitted.

6. By transfer of the shares.

7. By sale of the shares in execution of a decree of the court or a sale of the shares by the company in exercise of a power of lien over it for the dues of the company.

8. By a mortgage of the shares. Where shares are mortgaged and according to the terms of the mortgage, the shares have been transferred to the mortgagee, the latter can have his name registered as a member. If he does so the original member loses his membership.

9. By winding up. When the company is wound up according to the provisions of the Act, membership ceases to exist.

TRANSFER OF SHARES

Shares may be transferred in the manner provided for the purpose in the articles of the company and subject to the restrictions contained in the articles. The Companies Act contains the following provisions regarding transfer of shares :

1. A company shall not register a transfer unless the following documents are produced before it. (Sec. 108):

(a) a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and specifying the name, address and occupation, if any, of the transferee, and

(b) the certificate relating to the share, or if no certificate has been issued, the letter of allotment.

If the instrument is lost, the directors may allow the transfer, on such terms as to indemnity as they think fit.

The instrument of transfer is not required in cases of transmission of shares by operation of law but the company may require evidence of transmission.

2. The legal representative of a deceased member can transfer shares, although he is not himself a member.—Sec. 109.

3. An application for the registration of a transfer may be made either by the transferor or by the transferee. Where the application is made by the transferor and relates to a partly paid up share, the company must give notice to the transferee (by post) and the transfer can be registered only if the transferee makes no objection within two weeks of the time he ought to have received the notice by post.—Sec. 110.

4. The articles may empower the company to refuse to register a transfer or transmission of shares.—Sec. 111(1).

If, in the exercise of the powers conferred by the articles or otherwise, the company refuses to register a transfer or transmission, it must give notice of the fact to the transferor and the transferee or the person giving intimation of the transmission as the case may be, within two months of the time when the instrument of transfer or the intimation of transmission was delivered to the company.—Sec. 111(2).

5. *Appeal against refusal to transfer.* [Sec. 111(3) to 111(9)].

A. *In the case of a public company or a private company which is a subsidiary of a public company.* The transferor or the transferee or the person who gave intimation of the transmission may appeal to the Central Government against the company. The appeal must be filed within two months of the receipt of the notice of refusal, or where the company fails to give any notice, within two months after the expiry of the period within which such notice should have been issued. The appeal must be by a petition in writing and shall be accompanied by the prescribed fee.

The Central Government shall give an opportunity to the appellant, the previous owner, if any, and the company to represent their case. The Central Government may require the company to disclose the reasons why transfer was refused. If the company fails to disclose the reasons, the Government may presume that the disclosure, if made, would be unfavourable to the company.

The Central Government may reverse the decision of the company or confirm it. In the former case, the company must register the transfer within 10 days of the receipt of the order. The Government may also order the payment of costs to the aggrieved party.

All proceedings connected with the appeal shall be confidential. No suit shall lie concerning any allegation made in such proceedings.

B. *In the case of other private companies.* In such cases, the decision of the company to refuse registration cannot be challenged, except in one case. If any shares of such a company are sold in execution of a decree or the orders of a public authority and the purchaser's name is not registered, he can appeal to the Central Government. Such an appeal is dealt with in the same manner as an appeal against a public company. (See above.) There is, however, an additional provision for such cases. The Central Government may give an option to the company, either to accept the purchaser as a member or to get the shares purchased by a member of the company at a reasonable price to be determined by the Central Government.

Failure to carry out the orders of the Government is punishable with fine.

Case law concerning transfer of shares .

- (i) A transfer of shares remains incomplete until the transferee's name is registered. Pending registration, the transferor is trustee of the shares for the transferee. *Hardoon v. Belilios.*¹
- (ii) A transferee, not replying to a notice of transfer by the company, is not estopped from denying the validity of the transfer. *Barton v. L. & N. W. Rly Co.*²
- (iii) Where directors have power to refuse registration of a transfer, the power must be exercised in a *bona fide* and just manner. *Re. Coalport China Co.*³
- (iv) *Forged transfers* : If the instrument of transfer is forged and the company in good faith issues a certificate to the "transferee", the title of the real holder is not affected. The transferee's name may be removed from the register on appropriate steps being taken. *Barton v. L. & N. W. Rly Co.*¹ If the "transferee" sells the shares to a *bona fide* purchaser for value without notice, the purchaser gets no right to be a member of the company but he is entitled to damage from the company for having issued a share certificate on the basis of a forged instrument of transfer. *In re Bahia & San Francisco Rly. Co.*⁴

The company is entitled to get damage from the person who induced them to issue a share certificate on the basis of a forged instrument of transfer. *Sheffield Corporation v. Barclay.*⁵

¹ (1901) A. C. 118

² 24 Q. B. D. 77

³ (1895) 2 Ch. 404

⁴ 24 Q. B. D. 77

⁵ (1868) 3 Q. B. 595

⁶ (1905) A. C. 392

LODGING THE CERTIFICATE

When a person is the owner of a number of shares, the company issues only one certificate in respect of all the shares and not one for each share. It follows that when the holder transfers some of the shares he owns he has to deposit the share certificate with the company for the issue of a fresh certificate for the balance of the shares that remains in his ownership. When a certificate is deposited for this purpose the company writes on the instrument of transfer the words "certificate lodged" or other similar words. The original certificate is thereafter corrected and a fresh certificate issued.

BLANK TRANSFERS

A blank transfer is an instrument of transfer of shares, in which the name of the transferee is not mentioned. Whoever has the instrument has the implied authority of putting in his own name or the name of any other person as the transferee. An application can be made to the company to record the person, whose name is finally put on the instrument, as a member of the company. The utility of a blank transfer is that a single instrument can be used for several sales. Thus if *A* sells some shares to *B*, giving him a blank transfer, *B* can sell the shares to *C* by simply handing over the instrument to *C*. *C* can transfer the shares to *D* in the same way. *D*, if he wishes to be recorded as member can write down his own name on the transfer form and apply for registration.

The handing over of a transfer form executed in blank, does not by itself authorise the person to whom the form has been transferred to sell the share or get himself registered as the owner. Thus, if a person borrows money on the security of a share and gives to the lender the share together with a transfer form signed in blank, the lender is not entitled to sell the share except for non-payment of the amount lent.

CALLS

The Companies Act provides that 5% of the face value of a share must be paid with the application for the purchase of the share. The balance of the purchase-price is payable in the manner laid down in the articles.

Suppose that the face value of a share is Rs. 100. Five per cent of this, i.e. Rs. 5 is payable with the application. The balance Rs. 95, is payable upon allotment, or partly upon allotment and partly when demanded by the company. It may be provided that the company will demand the balance by a number of "calls" at different times.

When the company demands payment of any part of the purchase-price payable in this fashion, it is said to make a "call".

The decision to make a call must be taken by the Board of Directors and notified to the shareholders concerned. The formalities laid down in the articles regarding the making of calls must be scrupulously complied with. A call made in contravention of the provisions of the articles is invalid. *Re. Cawley & Co.*⁴ But irregularities of a trifling nature do not matter. *Dawson v. African Consolidated Co.*⁵ The power to make calls is of a fiduciary nature and must be exercised for the benefit of the company. *Lamb v. Sambas Rubber Co.*⁶

The Companies Act of 1956 lays down two rules regarding calls. Calls shall be made on a uniform basis on all shares falling under the same class, *i.e.* there must be no discrimination in favour of any shareholder. (Sec. 91). A company may, if so authorised by the articles, accept an advance payment of any part of the money due (*i.e.* before any call has been made). (Sec. 92). Such advance payment does not entitle the shareholder to any extra voting power. But a company may, if so authorised by the articles, pay dividends in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others.—Sec. 93.

When a call has been validly made, it becomes a debt due from the shareholder and the money can be recovered by suit.

LIEN

The articles of a Company may provide that the Company shall have a lien or a first charge on the shares of a member, for moneys due from him to the Company. In such cases if any share is mortgaged, the claims of the Company on the share, if any, will have priority over the claims of the mortgagee.

The lien on the shares, where it exists, extends also to the dividends payable on the shares and the assets receivable by the shareholder upon winding up. In *Allen v. Gold Reefs*,⁷ it was held that the company's lien continues after the death of the shareholder.

The articles usually empower a company to enforce its lien by a sale of the shares. But a lien cannot be enforced by forfeiture of shares.

FORFEITURE OF SHARES

The articles may provide that the shares of a shareholder can

⁴ 42 Ch. D. 209

⁵ (1898) 1 Ch. 6

⁶ (1908) 1 Ch. 845

⁷ (1900) 1 Ch. 656

be forfeited under certain circumstances, *e.g.* non-payment of calls. On forfeiture, the Company becomes the owner of the shares and they can be sold to others. The procedure laid down in the articles regarding forfeiture must be strictly complied with. Upon forfeiture the original shareholder ceases to be a member and his name must be removed from the Register of Members. The forfeited shares can be sold at any price.

The articles cannot empower forfeiture of shares for non-payment of debts other than calls. The power to forfeit is in the nature of a trust and must be exercised for the benefit of the company.

The purchaser of a share, forfeited for non-payment of calls, is liable to pay all unpaid calls due on the share. The company cannot sell a share free from the liability to pay calls. The original holder of the forfeited share remains liable as an ordinary debtor for the unpaid calls according to the provisions of the articles and can be sued for the debt.

SURRENDER OF SHARES

Surrender of shares, means abandonment of the shares by the holder thereof in favour of the Company. There is no provision in the Act or in Table A for surrender of shares. But the articles of a company may provide for the acceptance of a surrender under circumstances which would justify forfeiture. A surrender amounts to a reduction of capital. Therefore, the articles can provide for the acceptance of surrender only under circumstances which would justify forfeiture. Any provision in the articles, for the acceptance of surrender in other circumstances, is invalid. *Madras Native Fund v. Natesa Sastri*.⁸

EXERCISES

1. State concisely the *prima facie* rights of the holders of preference shares in a Company. (C. A. Nov. '49)
2. State and explain the circumstances under which the rights of holders of special classes of shares may be varied. (C. A., Nov. '51)
3. State and clearly explain the circumstances in which a company incorporated under the Companies Act may reduce its capital. (C.A. May '60)
4. State the provisions of the Companies Act relating to the issue of shares by a company at a discount or at a premium. (C.U. May '60)
5. Examine the right of a Company to purchase its own shares or to give loans for the purchase of its shares.
6. Write notes on—Deferred Shares; Redeemable Preference Shares; Equity Shares (C.U. '60); Forfeiture and Surrender of Shares; Certification of Shares; Share Certificate and Share Warrant; Stock.
7. What is preference share capital and equity share capital under the Companies Act, 1956? (C.U. '58)

CHAPTER 5

MEETINGS, RESOLUTIONS AND GENERAL MANAGEMENT

The corporate system of business organisation is essentially democratic in structure. The business of the Company is carried on by officials acting under the orders of the Board of Directors, which is the executive head of the Company. But the directors are elected to the Board by the shareholders of the Company and must abide by the wishes of the shareholders as expressed in resolutions passed in meetings convened for the purpose. The shareholders are, subject to the provisions of the Memorandum and the Articles, the final authority as regards the affairs of the Company. The shareholders cannot interfere in the day to day administration of the Company but they can elect Directors who will carry on the administration in the manner desired by them. Also, there are many matters which are beyond the powers of the Board of Directors to decide and which must be placed before the shareholders for decision. Meetings of shareholders are held for this purpose and the decisions of the shareholders are expressed in the form of resolutions.

MEETINGS

The Companies Act provides for three types of meetings : (i) the Statutory Meeting, (ii) General Meetings, including the Annual General Meeting, and (iii) the Extraordinary General Meeting on Requisition.

1. The Statutory Meeting. Every public company limited by shares and every company limited by guarantee and having a share-capital, must within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of members which is to be called the Statutory Meeting. In this meeting the members are to discuss a report by directors, known as the Statutory Report, which contains particulars relating to the formation of the Company.—Sec. 165(1).

The Statutory Report. This is a report drafted by directors and certified as correct by at least two of them (including the managing director, where there is one). A copy of the report must be sent to

every member, at least 21 days before the date of the meeting. A copy is also to be sent to the Registrar for registration. Section 165(3) provides that the Statutory Report must contain the following particulars :

- (a) the total number of fully paid up and partly paid up shares allotted;
- (b) the total amount of cash received by the company in respect of the shares;
- (c) an abstract of the receipts, classifying them according to source and mentioning the expenses incurred for commission, brokerage etc.;
- (d) the name, address and occupations of directors and of managing agents, secretaries etc.;
- (e) particulars of contracts which are to be submitted to the meeting for approval, with proposed modifications, if any;
- (f) if any underwriting contracts have not been carried out, the reasons therefor;
- (g) the arrears due on calls from directors and others;
- (h) particulars of commissions and brokerages paid to directors, managing agents, secretaries and treasurers.

Particulars as regards cash in the statutory report are to be certified as correct by the auditors of the Company.

The members of the company who are present in the Statutory Meeting are at liberty to discuss any matter relating to the formation of the company or arising out of the Statutory Report, whether previous notice has been given or not. But no resolution can be passed of which notice has not been given in accordance with the provisions of the Act.

If default is made in complying with the provisions of Section 165, every director or other officer of the company who is in default shall be punishable with fine which may extend to Rs. 500.

2. The Annual General Meeting. Section 166 of the Act, as amended in 1960, provides that every company shall in each year hold an Annual General Meeting in addition to any other general meetings that might be held. The statutory provisions regarding the Annual General Meeting are summarised below.

(a) *Section 166.* The first Annual General Meeting of a company may be held within a period of not more than 18 months from the

date of its incorporation. If such a meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year.

Subject to the abovementioned provision, a company must hold an annual general meeting *each* year. Not more than 15 months shall elapse between the date of one annual general meeting and the next.

The Registrar may, for any special reason, extend the time of holding an annual general meeting (other than the first annual general meeting) by a period not exceeding 3 months.

The notice, by which an annual general meeting is called, must specify it as such.

Every annual general meeting shall be called during business hours, on a day which is not a public holiday, at the Registered Office of the Company or at some other place within the town or village where the Registered Office is situated. The Central Government may exempt any class of companies from the provisions mentioned in this paragraph.

The time of holding of the annual general meeting may be fixed by the articles of the company.

A public company or a private company which is a subsidiary of a public company may, by a resolution passed in one general meeting, fix the time for its subsequent general meetings. Other private companies may do so by a resolution agreed to by *all* the members thereof.

(b) *Sec. 167.* If default is made in holding an annual general meeting in accordance with Sec. 166, the Central Government may (on the application of any member of the company) call or direct the calling of a general meeting. It may also give directions regarding the calling, holding and conducting the meeting. Such a meeting shall be deemed to be an annual general meeting of the company.

(c) *Sec. 168.* If the provisions of Sections 166 and 167 are not complied with, the company and every officer of the company in default shall be fined. (Maximum fine—Rs. 5,000. For continuing default—further fine of Rs. 250 per day.)

(d) *Sec. 171.* A general meeting may be called by giving not less than 21 days' notice in writing. The annual general meeting may be called with a shorter notice if it is agreed to by *all* the members entitled to vote in the meeting.

General Meetings (other than the Annual General Meeting). The Board of directors can call a general meeting of the members any time by giving not less than 21 days' notice. A general meeting (other than the annual general meeting) may be called with a shorter notice if 95 per cent of the members, entitled to vote, give their consent.

3. **Extraordinary General Meeting on requisition.** The Board of directors can be compelled to hold a General Meeting upon request or requisition made for it, under the following conditions.—Sec. 169.

(a) The requisition must be signed by members holding at least 1/10th of the paid up capital of the Company, in the case of Companies having a share-capital; and by members holding at least 1/10th of the total voting power in other cases

(b) The requisition must set out the matters which will be considered at the meeting.

(c) The requisition must be deposited at the registered office of the Company.

The Board must, within 21 days of the receipt of a valid requisition, issue a notice for the holding of the meeting on a date fixed within 45 days of the receipt of the requisition. If the Board does not hold the meeting as aforesaid, the requisitionists can call a meeting to be held on a date fixed within 3 months of the date of requisition.

Resolutions, properly passed at a meeting called by the requisitionists, are binding on the Company. A General Meeting, held on requisition, is the only form of Extraordinary General Meeting recognised in the Act of 1956.

RULES OF PROCEDURE REGARDING MEETINGS

The general rules of procedure as regards shareholders' meetings can be summarised as follows :

1. **Notice.** (Sec. 172). Notice of every meeting must be given to (a) all members entitled to vote upon the matters which are proposed to be dealt with in the meeting; (b) the legal representatives of deceased or insolvent members coming under the above category; and (c) the auditors of the Company. Notice must be given at least 21 days before the meeting, unless 95% of the members, entitled to notice, consent to a shorter notice. (In the case of the Annual General Meeting, there may be a shorter notice if it is consented to by *all* the members entitled to vote.)

2. **The Agenda.** (Sec. 173). The notice must specify the business to be transacted in the meeting. The business transacted in a

shareholders' meeting, can be divided into two classes, (i) Ordinary and (ii) Special. Ordinary business means: consideration of accounts and the balance sheet; declaration of dividend; appointment of directors; and appointment of and fixation of remuneration of auditors. All other business is special business.

3. **The Quorum.** (Sec. 174). Quorum means the minimum number of members required to hold a meeting. According to the Act, quorum is constituted by 5 and 2 members, personally present, for public and private companies respectively. But the articles may prescribe a large number.

If there is no quorum within half an hour of the notified time for starting the meeting, it is dissolved. If the meeting is one called upon requisition, no further meeting on the same notice is permitted. In other cases, the meeting is automatically adjourned to the same day next week at the same hour and place or at such other day, hour and place as the Board may determine.

No quorum is necessary in an adjourned meeting.

4. **Chairman.** (Sec. 175). Unless otherwise laid down in the articles, the members personally present at the meeting shall elect a Chairman, from among themselves, by show of hands. But if a poll is demanded, it must be taken forthwith with a Chairman elected for the purpose. (Poll means secret voting by ballot papers.)

5. **Proxy.** (Sec. 176). Any member, entitled to attend and vote in a meeting, can appoint another person to attend and vote on his behalf. The person appointed is called the Proxy. The appointment of a proxy must be made by a written instrument signed by the appointer and deposited with the Company, not more than 48 hours before the meeting.

A proxy is not entitled to speak in the meeting and *can vote only on a poll* unless the articles provide otherwise. A proxy need not be a member of the Company. A member of a private company cannot appoint more than one proxy to attend on the same occasion, unless the articles otherwise provide.

A member entitled to vote can inspect the proxy forms deposited, if he gives 3 days' notice of his intention to do so.

An instrument appointing a proxy, if in one of the forms set out in Schedule IX to the Act, cannot be questioned on the ground that it fails to comply with any special requirement specified for such instruments in the articles.

Every notice of meeting must prominently mention that a mem-

ber is entitled to appoint a proxy and that the proxy need not be a member.

A body corporate, which is a member of a Company, can appoint a representative or proxy, by resolution of the Board.

The President of India or the Governor of a State, if he is a member of a company, may appoint any person to act as his representative in a meeting.—Sec. 187A.

6. Method of Voting. (Sections 177-185). Resolutions are to be voted upon, in the first instance, by show of hands. The Chairman's declaration of the results of voting by show of hands, is conclusive.

A poll is to be taken (i) if the Chairman so directs ; (ii) in all cases, if it is demanded by members holding at least 1/10 of the voting power or paid up capital ; (iii) in the case of public companies if it is demanded by at least 5 members present and entitled to vote ; and (iv) in the case of private companies by one member if not more than seven members are present and by two members if more than seven members are present.

A poll on a resolution for adjournment, or for the appointment of a Chairman is to be taken immediately. In other cases it is to be taken when the Chairman decides ; but it must be within 48 hours of the demand for poll.

A poll is to be taken in the manner decided by the Chairman. The usual method is to ask each member to record his decision on ballot papers provided for the purpose. The Chairman shall appoint two scrutineers to scrutinise the ballot papers. At least one of them shall be a member present in the meeting, if a member, willing to act as such, is found.

The Chairman has a casting vote in addition to his ordinary vote, *i.e.* in case of a tie, he can give another vote, either for or against the resolution.

7. Restrictions on voting power. An equity shareholder can vote on all resolutions ; a preference shareholder can vote only on questions affecting his interests, except where the dividend payable is in arrears. (See Ch. 4 under "Voting rights of Shareholders".)

The articles of a Company may provide that a member shall not exercise voting power in respect of a share on which a call, or any other sum due to the Company, has not been paid. No other restriction on voting right can be imposed.—Sections 181, 182.

RESOLUTIONS

Prior to 1956, resolutions of members were of three types: ordinary, special and extraordinary. The Act of 1956 classifies resolutions into two types: (i) Special and (ii) Ordinary.

Special Resolution. A special resolution is necessary for deciding important matters. The Act specifies what these matters are. *Examples:* Reduction of Capital; Winding up.)

Procedure for passing a Special Resolution. A special resolution may be passed in a general meeting of members called in the usual way with the usual notice. But the following conditions must be satisfied.—Sec. 189.

(a) The notice calling the general meeting must specify that a special resolution will be moved.

(b) The number of votes cast in favour of the resolution whether by show of hands or by poll, must be at least three times the number cast against it.

Ordinary Resolution. All matters, not required to be decided by a special resolution, may be decided by ordinary resolution. An ordinary resolution is passed, when the number of votes cast in its favour exceeds those cast against it.

Members' Resolutions. If members of a Company intend to move a resolution, at the next annual general meeting, the following procedure is to be adopted. (Sec. 188):

1. A resolution in writing, with a copy of the resolution, must be deposited with the Company. If it is desired to circulate the requisition to the members, it must be deposited not less than 6 weeks before the meeting. In other cases it may be deposited not less than 3 weeks before the meeting.

2. The requisition must be signed (a) by members holding at least 1/10th of the total voting power, or (b) by not less than 100 members, holding shares with an aggregate paid up capital of Rs. 1 lakh.

3. The requisition may require the circulation to the members, along with the resolution, a statement of not more than 1000 words relating to the resolution.

4. The requisitionists must pay the expenses necessary for circulating the notice and the statement.

If the aforesaid procedure is complied with, the resolution must be dealt with at the next annual general meeting. But the statement, if any is sent with the resolution will not be circulated in the following cases:

- (a) If the Company is a banking company and the Board of Directors is of opinion that its circulation will injure the interest of the Company.
- (b) If on an application made by the company or of any person feeling aggrieved, the court is satisfied that the rights conferred by Section 188 are being abused to secure needless publicity for defamatory matter, it may prohibit the circulation.

Special Notice. Where by any provision contained in the Act or in the articles, *special notice* is required of any resolution, the intention to move the resolution shall be given to the Company not less than 14 days before the date of meeting where the resolution is to be moved. The Company shall give notice of the resolution to the members in the same manner as it gives notice of the meeting. If this is not practicable, it shall give notice by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles, not less than 7 days before the meeting.—Sec. 190.

Registration of Resolutions. All special resolutions and important resolutions (like appointment of Managing Agents or voluntary liquidation) must, within 15 days of their adoption be registered with the Registrar and also annexed to all copies of the articles.—Sec. 192.

MINUTES OF PROCEEDINGS

By the term “minutes” is meant a written record of the proceedings of a meeting. As company meetings are of considerable legal importance, it is necessary to keep a record of the proceedings in a permanent form. Section 193 of the Act provides as follows :

(1) Every company shall keep minutes of all proceedings of every general meeting, meetings of its Board of Directors, and of every committee of the Board. Entries in the minute books must be made within 14 days of the conclusion of a meeting. The pages of a minute book must be consecutively numbered. Each page must be initialled or signed and the last page recording the proceedings of a meeting must be dated and signed (a) in the case of Board meetings or committee meetings, by the Chairman of the meeting or the succeeding meeting, and (b) in the case of general meetings, by the Chairman of the same meeting, or in the event of his death or inability, by a director duly authorised by the Board. Entries in a minute book must not be attached to it by pasting or otherwise.

(2) The minutes of each meeting shall contain a fair and correct summary of the proceedings.

(3) All appointments of officers made at the meeting shall be included in the minutes.

(4) In the case of a meeting of the Board of directors or of a committee of the Board, the minutes shall also contain—

(a) the names of the directors present at the meeting, and

(b) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring in, the resolution.

(5) The minutes need not contain any matter which, in the opinion of the chairman of the meeting—

(a) is, or could reasonably be regarded as, defamatory of any person ;

(b) is irrelevant or immaterial to the proceedings, or

(c) is detrimental to the interests of the company.

The Chairman's discretion, as regards what is to be included in the minutes, is final.

The minutes kept in accordance with the aforesaid rules shall be evidence of the proceedings in a meeting. They are presumed to be correct records of proceedings, unless otherwise proved. The minutes of general meetings are to be kept at the registered office of the Company and can be inspected by members. Copies of any minutes are to be furnished upon payment of the requisite fees.

Apart from the minutes, no reports of the proceedings of a general meeting are to be published at the expense of the Company.

CONTRACTS AND DEEDS OF A COMPANY

Contracts which may be made orally by private persons, may be made orally on behalf of Companies by any person acting under the authority of the Company, express or implied. Such contracts may be varied and discharged in the same manner.—Sec. 46 (1) (b).

Contracts which require to be in writing, must be in writing and must be signed by some person acting under the authority of the Company, express or implied. Such contracts may be varied and discharged in the same manner.—Sec. 46 (1) (a).

A bill of exchange, hundi or promissory note shall be deemed to have been made, accepted, drawn or endorsed on behalf of a company when so done in the name of, or on behalf or on account of the com-

pany by any person acting under its authority, express or implied.—Sec. 47.

Deeds, on behalf of a Company must be executed by some person authorised by the Company by a general or special power of attorney. The common seal of the Company must be affixed.—Sec. 48.

All investments made by the Company on its own behalf shall be made and held in its own name or, where so permitted, in the name of a nominee. This rule does not apply to a Company whose business is buying and selling of securities.—Sec. 49.

Where authentication of documents and proceedings by the Company is required it may be done by any Director, the Managing Agent, the Secretaries and Treasurers, the Manager, the Secretary or other authorised officer of the company. It is not necessary to use the common seal.—Sec. 54.

SERVICE OF DOCUMENTS

Documents may be served on a Company by sending it to the registered office by registered post or under certificate of posting or by leaving it at the registered office.—Sec. 51. The same is the procedure for serving a document on the Registrar.—Sec. 52.

Service of documents on a member may be done personally or by sending it to him by post to the address supplied by him to the company.—Sec. 53.

ANNUAL RETURN

The Annual Return is a statement of particulars, which is required to be filed by a company after every annual general meeting. Section 159 of the Act provides that every company having a share capital shall, within forty-two days from the day on which each annual meeting is held, prepare and file with the Registrar a return containing particulars regarding the following :

- (a) its registered office,
- (b) the register of its members,
- (c) the register of its debenture holders,
- (d) its shares and debentures,
- (e) its indebtedness,
- (f) its members and debenture holders, past and present, and
- (g) its directors, managing directors, managing agents, secre-

taries and treasurers, managers and secretaries, past and present.

Where full particulars as to past or present members were given in any of the two immediately preceding Returns, a Return may mention only the changes that have occurred in shareholding.

The Return must be in the form set out in Part II of Schedule V or as near thereto as circumstances admit.

A similar return is to be filed by Companies not having a share capital.—Sec. 160.

The Annual Return shall be signed by a Director and the Managing Director, Secretary or Treasurer, or by two Directors.—Sec. 161 (1).

In the case of private companies, the directors must certify that there has been no violation of the rules of private companies regarding number of members and invitation to the public for purchase of shares.—Sec. 161 (2) (b). The directors must also certify that 25% or more of the shares are not being held by any bodies corporate and if so, why the company will continue to be treated as a private company.—Sec. 43A.

MANAGERIAL REMUNERATION

The Act of 1956 contains certain rules regarding the total remuneration payable to Directors, Managers etc. They are as follows.—Sec. 198.

In the case of a public company or a private company which is a subsidiary of a public company, the *total* remuneration payable by the Company to its Directors, Managing Agents, or Secretaries and Treasurers, if any, and Manager, if any, shall not exceed 11% of its net profits.

The term 'remuneration' includes expenditure by the company on rent-free accommodation, other amenities and life insurance premia.

If, in any financial year, no profits or inadequate profits have been made, remuneration may be given up to Rs. 50,000 in all, subject to the approval of the Central Government. Where a monthly payment is made to managing or whole time directors, the Central Government, on the application of the Company, may sanction a higher amount.

Net profits are to be calculated in the manner laid down in

Sections 349-351 of the Act except that the remuneration of the directors shall not be deducted from the gross profits. [See Ch. 8.]

No Company shall after the commencement of the Act of 1956 pay any officer, any remuneration calculated free of income-tax or super-tax.—Sec. 200.

There shall be no provision in the articles or in any agreement relieving a person in the employment of a Company from the duty of indemnifying the Company from damages for negligence, breach of trust etc., except against any liability incurred for defending himself in any suit or criminal proceedings, provided judgment has been given in his favour.—Sec. 201.

PREVENTION OF MANAGEMENT BY UNDESIRABLE PERSONS

If an undischarged insolvent acts as director, or discharges the functions of managing agent, secretaries and treasurers, or manager ; or, directly or indirectly takes part in the promotion, formation or management of a Company, he may be sentenced to imprisonment for 2 years or fined up to Rs. 5000.—Sec. 202. In this section the term company includes an unregistered company and a body corporate incorporated outside India, which has an established place of business within India.

The Court may prohibit persons found guilty of fraudulent conduct, from participation in the management or formation of a Company.—Sec. 203.

A body corporate cannot be appointed to a place of profit under a Company for a term exceeding 5 years at a time (except to the posts of managing agent, secretaries and treasurers and trustees for debenture holders).—Sec. 204.

PAYMENT OF INTEREST OUT OF CAPITAL

A company cannot pay interest out of its capital, except in the following cases. (Sec. 208) :

(1) where any shares in a Company are issued for the purpose of raising money to defray the expenses of the construction of any work or building, or the provision of any plant, which cannot be made profitable for a lengthy period;

(2) the payment of interest out of capital is authorised by the articles, or by a special resolution; and,

(3) the prior sanction of the Central Government is obtained.

Before sanctioning the payment of interest out of capital, the Central Government may, at the expense of the Company, appoint a person to enquire into and report to the Central Government on the circumstances of the case.

The payment of interest shall be made only for such period as may be determined by the Central Government. The period shall in no case extend beyond the close of the half year next after the half year during which the work or building has been actually completed or the plant provided.

The rate of interest must not exceed 4% or such rate as the Central Government may fix by notification.

Section 208 does not apply in the case of railways and tramways.

SCHEMES OF ARRANGEMENT, RECONSTRUCTION AND AMALGAMATION

A Company may find it necessary to settle or compromise with its creditors or with particular groups of shareholders. For this purpose it may be necessary to reorganise its structure or to amalgamate with another Company. Sections 391 to 395 of the Companies Act lay down the procedure for such re-organisation and amalgamation. The procedure is summarised below.

I. Schemes for Arrangement

The expression "Arrangement" includes a re-organisation of the share-capital of the Company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods.

A compromise or arrangement may be proposed (a) between the company and its creditors or any class of them; or (b) between a company and its members or any class of them.

Upon such a proposal being made, the company, or any creditor, or any member, or the liquidator (if the company is in the process of being wound up) may apply to the court for an order directing the holding of a meeting of the members or the creditors concerned.

If in such a meeting the proposed scheme or arrangement is accepted by a majority representing at least 3/4ths in value of the creditors or members concerned, and if thereafter, the scheme is sanctioned by the court, it becomes binding on the company and all parties concerned and the scheme must be given effect to.

A certified copy of the Court's order is to be filed with the Registrar and annexed to every copy of the memorandum issued subsequently.

When a scheme is sanctioned by the High Court, it shall have power to supervise the carrying out of the arrangement and to issue directions concerning the same.

Information of the arrangement shall be given to all persons concerned.

II. Amalgamation through the Court

A scheme of compromise or arrangement may involve the amalgamation of one company with another by the transfer of the whole or part of any company to another. In such cases the scheme must be approved by holders of three-fourths in value of the shares concerned and sanctioned by the court. The procedure is the same as that outlined in I. above. While sanctioning the scheme the court can facilitate the amalgamation by passing orders for any of the following purposes :

(a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company ;

(b) the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person ;

(c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company ;

(d) the dissolution, without winding up, of any transferor company ;

(e) the provision to be made for any person who, within such time and in such manner as the Court directs, dissent from the compromise or arrangement ; and

(f) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

III. Compulsory purchase of the shares of dissenting shareholders (Sec. 395).

Where a scheme or contract involving the transfer of shares of one company to another has been approved by the holders of not less than nine-tenths in value of the shares involved within four months of the date of making the offer, the transferee company may, at any time within two months after the expiry of the said four months, give notice to any dissenting shareholder that it desires to acquire his share. Upon such notice being given, the transferee com-

pany becomes entitled and bound to acquire the shares, within one month of the date of notice, on the same terms as those on which the shares of the approving members are being acquired under the scheme.

~~A dissenting shareholder may apply to the court within one month of the notice, for an order prohibiting the purchase. The court may do so if sufficient grounds are shown.~~

The right of compulsory purchase can be exercised when the transferee company already holds a certain proportion of the shares in question.

After the formalities have been complied with and the instrument of transfer has been executed by the shareholders or by any person appointed by the transferee company, the purchase price of the shares together with the instrument of transfer is to be deposited with the transferor company. Thereupon the transferor company shall record the name of the transferee company as the holder of the shares. The purchase price paid is to be held in trust for payment to the persons entitled to it.

Through the procedure provided by Section 395, it is possible to carry through a scheme of amalgamation, without the assistance of the court.

IV. Amalgamation by Order of Central Government (Sec. 396)

Where the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, it may, by order notified, in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution; with such property, power, rights, interests, authorities and privileges; and with such liabilities, and obligations; as may be specified in the order.

The order of the Central Government may contain such consequential, incidental and supplemental provisions as may be necessary to give effect to the amalgamation.

Members and creditors (including debenture-holders) of the original companies shall have, against the new company, as nearly as possible the same rights as they had against the original companies. If the rights and interests of any member or creditor is affected prejudicially by the amalgamation, he will be entitled to compensation, the amount of which will be determined by such authority as may be prescribed. The compensation will be paid by the new company.

Before issuing the order of amalgamation, the Central Government will send a copy of the proposed order in draft to each of the

companies concerned and will consider their suggestions and objections if any.

Copies of the order of amalgamation must be laid before both houses of Parliament.

CONTRACTS WHERE A COMPANY IS UNDISCLOSED PRINCIPAL

Section 416 of the Companies Act provides that if the managing agent, secretaries and treasurers, manager or other agent of a public company (or of a private company which is a subsidiary of a public company) enters into a contract for or on behalf of the company, in which contract the company is an undisclosed principal, he shall, at the time of entering into the contract, make a memorandum in writing of the terms of the contract, and specify therein the persons with whom it is entered into. The memorandum shall be delivered forthwith to the company and a copy sent to each of the directors. The memorandum shall be filed in the office of the company and laid before the Board of directors at its next meeting.

If default is made in complying with the above requirements—

(a) the contract shall, at the option of the company, be voidable as against the company; and

(b) the person who enters into the contract, or every officer of the company who is in default, as the case may be, shall be punishable with fine which may extend to two hundred rupees.

EMPLOYEE'S SECURITIES AND PROVIDENT FUNDS

Moneys and securities deposited with the Company by employees in pursuance of their contract of service, shall be kept or deposited (within 15 days of deposit) (a) in a post office savings account, or (b) in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or (c) where the company itself is a Scheduled Bank, in a special account to be opened either in itself or in the State Bank of India or in any other Scheduled Bank. No part of such moneys can be used by the Company for any purpose other than the purposes agreed to in the contract of service.—Sec. 417.

Moneys contributed, received or accruing to an employees' provident fund must, within 15 days from the date of contribution, receipt or accrual, be either deposited in the institutions mentioned above (where employees' securities are deposited) or be invested in trustee securities. Where there are trustees for a provident fund, all

such moneys must be paid to the trustees within 15 days from the date of collection.—Sec. 418.

An employee is entitled, on request, to see the bank's receipt for the money or securities referred to in Sections 417 and 418.—Sec. 419.

Any officer of the company and any trustee of a provident fund who contravenes or authorises or permits the contravention of the aforesaid rules, is punishable with imprisonment up to 6 months or fine which may extend to Rs. 1000.—Sec. 420.

EXERCISES

1. Examine the various kinds of general meetings recognised by the Indian Companies Act and point out when and how these meetings are to be held. (C. A., Nov. '53)

2. What are the provisions of the Companies Act relating to the convening of extraordinary general meetings on the requisition of members? (C. A., Nov. '54)

3. What are the different types of resolutions that might be passed by the members of a Company?

4. Discuss the extent of the powers of a limited liability Company to enter into compromises or schemes of arrangement and indicate the procedure to be adopted for the purpose. (C. A., May '55)

5. How are moneys and securities deposited with a Company by its employees under their contract of service kept? (C. A., May '52).

6. Write notes on—Amalgamation; Annual Report; Proxy; Special Resolution; Statutory Report (C. U. '60); Reconstruction.

CHAPTER 6

DIRECTORS

The Directors of a Company, selected according to the provisions of the articles and the rules laid down in the Companies Act, are in charge of the management of the affairs of the Company. The directors are collectively called the Board of directors. The Board is the Company's executive authority.

The welfare of the shareholders and of the company depends upon who the directors are and how they carry out their duties and responsibilities. To protect the interests of the Company and of the shareholders, the Companies Act contains detailed rules regarding the appointment, remuneration, powers, duties, liabilities and various other matters concerning directors.

NUMBER OF DIRECTORS

The number of directors to be appointed to the Board of directors of a Company is determined by the articles. But there must be at least 3 directors in a Public Company and at least 2 directors in a private company.—Sec. 252. [Under the Act of 1956, a private company which is a subsidiary of a public company, was required to have at least 3 directors. This has been changed by the amending Act of 1960.]

Subject to the minimum stated above and the maximum fixed by the articles, the Company can, by ordinary resolution, increase or decrease the number of directors. It can also appoint additional directors for one year.—Sec. 258.

The Company can increase the number of directors beyond the maximum fixed by the articles provided previous sanction of the Central Government is obtained.—Sec. 259.

MODE OF APPOINTMENT OF DIRECTORS

1. Persons named in the articles of association as directors become the first directors of the Company. In the case of public companies, the persons named as directors must file with the Registrar, their consent in writing to become directors and must agree to pay for the minimum number of shares which, by the articles, a director is required to have.

2. If no person is named in the articles as directors, the persons who sign the memorandum of association of the Company (and who are individuals, not companies) become the first directors.—Sec. 254.

3. The normal mode of appointing directors is election by the members at the annual general meeting. The manner of holding the election must be provided for in the articles.—Sec. 255.

4. Casual vacancies among directors in public companies and private subsidiaries of public companies may be filled by the Board of directors by nomination. The person appointed to a casual vacancy holds office for the period during which the director, whose post is vacant, would have remained in office.—Sec. 262.

5. The Government can nominate a director to the Board of a Company coming within the purview of the Industries (Development and Regulation) Act of 1951. Certain statutory corporations possess similar powers. For example, the Industrial Finance Corporation Act of 1947 empowers the Corporation to nominate a director to the Board of a Company to which it has advanced money.

6. Under Section 408 of the Act, the Central Government can (in cases of mismanagement and oppression) nominate not more than two directors to the Board.

7. The Managing Agents of a Company may, if so authorised by the articles, appoint not more than two directors where the total number of directors exceeds five and one director where the total number does not exceed five.—Sec. 377.

If the managing agent appoints one of the employees of the company or an employee or associate of the managing agent as director, the appointment must, except in certain special cases, be confirmed by a special resolution of the company.—Sec. 261.

Certain general rules regarding the appointment of directors are mentioned below :

1. **Qualification Shares.** (Sections 270-273). The articles may provide that no person shall be eligible for appointment as director unless he holds a certain minimum number of shares. Such shares are called Qualification Shares. Section 270 of the Act lays down that in the case of public companies, the following provisions shall apply notwithstanding anything to the contrary contained, in the articles :

(a) A director shall be deemed to be qualified if he secures the qualification shares within two months *after* his appointment.

(b) The nominal value of the qualification share or shares shall

not exceed Rs. 5000, or the nominal value of one share where it exceeds Rs. 5000.

(c) Every director, not being a Technical director appointed by the Central Government or any State Government, must file with the Registrar a statement of his share qualification within two months after his appointment.

(d) The bearer of a share warrant shall not be deemed holder of shares for the purposes of qualification shares.

If after the expiry of the said period of two months, any person acts as a director of the company when he does not hold qualification shares, he shall be punishable with fine which may extend to Rs. 50 for every day between such expiry and the last day on which he acted as director.—Sec. 272. Also he has to vacate his office as director.

According to the Act every director must pay for the qualification shares. Therefore, if a director obtains his qualification shares as a present from the promoters, it amounts to a breach of trust. *Re London and South Western Canal Co., Ltd.*¹

2. Notice. In the case of public companies and private companies which are subsidiaries of public companies, when it is intended to propose the name of some person as director, notice of the fact must be given by the candidate or the proposer to the Company at least 14 days before the date of the meeting in which the election will take place. This provision does not apply to a retiring director. The company shall inform every member of the candidature by individual notices not less than 7 days before the meeting or by advertisement in two local newspapers (one English and one regional language paper) not less than 7 days before the meeting.—Sec. 257.

3. Filing of Consent. In the case of public companies and private subsidiaries of public companies every person proposed as director must sign and file with the company his consent to act as such if appointed, unless he himself notifies his candidature to the company. A person (other than a director reappointed after retirement by rotation) shall not act as director unless he has within 90 days of his appointment signed and filed with the Registrar his consent in writing to be one.—Sec. 264.

4. Method of Voting. Every person, proposed for election as a director, must be voted upon individually. Two or more names are not to be put up together, unless such a procedure is agreed to by the members present unanimously. The articles may provide for the election of not less than two-thirds of the directors by the method

¹ (1911) 1 Ch. 346

of proportional representation with single transferable votes or cumulative votes. A non-profit and non-dividend paying company may provide in its articles for the election of all its directors by ballot. Sections 263, 263A, 265.

5. Alternate Directors. The Board of directors of a Company may, if so authorised by its articles or by a resolution passed by the Company in a general meeting, appoint an alternate director to act for a director during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held. The alternate director cannot hold office longer than the original director and vacates his office if and when the original director returns to the State.—Sec. 313.

6. Amendment of Provision relating to appointment of Directors. In the case of a public company or a private company which is a subsidiary of a public company, an amendment of any provision relating to the appointment or re-appointment of a managing or whole-time director or of a director not liable to retire by rotation, whether that provision be contained in the Company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the Company in general meeting or by its Board of directors, shall not have any effect unless, approved by the Central Government; and the amendment shall become void if, and in so far as, it is disapproved by that Government.—Sec 268.

7. Directors to be Individuals. A body corporate, association or firm cannot be appointed director, only an individual can be so appointed.—Sec. 253.

8. Disqualification of Directors. Section 274 provides as follows: A person shall not be capable of being appointed director of a company, if—

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence;

(e) he has not paid any call in respect of shares of the Company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call; or

(f) an order disqualifying him for appointment as director has been passed by a Court in pursuance of Section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that Section.

[Section 203 empowers the Court to prohibit a person, who is guilty of fraudulent practices, from participating in the management of Companies.]

The Central Government may, by notification in the Official Gazette, remove the disqualifications under Clauses (d) and (e) above, as regards any individual.

A private Company, which is not a subsidiary of a public Company, may provide by its articles that a person shall be disqualified from being appointed a director on any grounds in addition to those specified in (a) to (f) above.

9. Number of Directorships. After the commencement of the Act of 1956, no person can hold office as director, at the same time, of more than 20 companies.—Sec. 275.

But the following companies are *not to be taken into account* while calculating the maximum allowable appointments as director : (a) a private company which is neither a subsidiary nor a holding company of a public company ; (b) an unlimited company ; (c) an association not carrying on business for profit ; and (d) a Company in which the person concerned is only an alternate director.—Sec. 278.

A person who contravenes this rule can be fined up to Rs. 5000 for each Company of which he is a director in excess of 20.—Sec. 279.

10. Retiring Age of Directors. No person can be appointed director of a public company or of a private company which is the subsidiary of a public company, if he has attained the age of 65. A person, already a director, must vacate office at the conclusion of the annual general meeting commencing next after he attains the age of 65 years. But a person, who has been appointed director before he was 65, shall not be required to vacate his office within a period of 3 years merely because he has attained the age of 65 within that period.—Sec. 280.

But a person, who has attained the age of 65, can be appointed director if his appointment is approved by a resolution (of which special notice was given) passed in a general meeting of the Company.—Sec. 281.

It is the duty of a director to disclose his age.—Sec. 282.

RETIREMENT OF DIRECTORS

Section 255 of the Companies Act provides that *not less than two-thirds* of the total number of directors of a public company, or of a private company which is a subsidiary of a public company, shall be persons whose period of office is liable to terminate by rotation. The articles may provide for the retirement of *all* directors at every annual general meeting.

Section 256 of the Act provides that at every annual general meeting after the one by which the first directors are appointed, one-third of such of the directors for the time being as are liable to retire by rotation, shall retire from office. If the number of directors is not three or a multiple of three, then the number nearest to one-third shall so retire.

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

At the annual general meeting at which a director retires as aforesaid, the Company may fill up the vacancy by appointing the retiring director or some other person thereto.

If the vacancy is not filled at the annual general meeting or at the adjourned meeting, the retiring directors will be deemed to be automatically re-elected.

VACATION OF OFFICE BY DIRECTORS

1. Section 283 of the Companies Act provides that the office of a director shall become vacant under the following circumstances :

(a) if he fails to obtain within due time or ceases to hold the share qualification, if any, required of him by the articles of the Company ;

(b) if he is found to be of unsound mind by a Court of competent jurisdiction ;

(c) if he applies to be adjudicated an insolvent ;

(d) if he is adjudged an insolvent ;

(e) if he is convicted by a Court of any offence involving moral turpitude and is sentenced in respect thereof to imprisonment for not less than six months ;

(f) if he fails to pay any call in respect of shares of the Company held by him whether alone or jointly with others within six months from the last date fixed for the payment of the call, unless the Central

Government has by notification in the Official Gazette removed the disqualification incurred by such failure;

(g) if he absents himself from three consecutive meetings of the Board, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board ;

(h) if he (whether by himself or by any person for his benefit or on his account) or any firm in which he is a partner or any private Company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the Company in contravention of Section 259 ; [Section 259 deals with the rules relating to the grant of loans to directors.]

(i) if he acts in contravention of Section 299 (which imposes a duty on directors to disclose their personal interest, if any, in any contracts entered into by the Company) ;

(j) if he becomes disqualified by an order of Court under Section 203 (which provides that the Court can prohibit a person guilty of fraudulent practices from managing a company) ;

(k) if he is removed from the post of director by the members; or

(l) having been appointed a director by virtue of his holding any office or other employment in the company, or as a nominee of the managing agent of the company, he ceases to hold such office or other employment in the company or, as the case may be, the managing agency comes to an end.

In case of insolvency or conviction, the director shall vacate office within 30 days of the order of adjudication or sentence. But if there is any appeal or petition against the order of adjudication or sentence, he shall vacate office within seven days of the disposal of the appeal or petition, unless the order or sentence is set aside.

If a director continues to function when he knows that his post has become vacant under any of the aforesaid provisions, he is liable to a fine up to Rs. 500 per day.

2. A private Company, which is not a subsidiary of a public Company, may by its articles provide that the office of director shall be vacated on any grounds in addition to those specified under Section 283.

3. Under Section 314 of the Act, if a director accepts an office of profit under the company (except certain special posts like that of a managing director, managing agent etc.) without the previous consent of the company accorded by a special resolution, he shall

be deemed to have vacated his office as director. (See, *post* re. 'office of profit'.)

4. Under Section 280, a director must vacate his office at the conclusion of the annual general meeting commencing next after he attains the age of 65 years. This rule is subject to certain exceptions. See *ante*.

REMOVAL OF DIRECTORS

Section 284 of the Act provides that the members of a Company may, by ordinary resolution, remove a director before the expiry of his period of office, except in the following cases :

1. An additional director appointed by the Central Government under Section 408 (in cases of mismanagement and oppression) cannot be removed.

2. Where, in a private Company, a director was appointed for life and was holding office as such on 1st April 1952, he cannot be removed by a members' resolution.

3. Where the articles of a Company provide for the election of directors by proportional representation, a director elected by that method cannot be removed by resolution.

Special notice must be given of the resolution to remove a director. A copy of it must be given to the director concerned. A statement relating to the matter may be sent by the director concerned, to the company and such statement shall be circulated among the members, if received in time, or read out in the meeting. The circulation of such statement may be prohibited by Court if it contains defamatory matter.

The meeting which removes a director can elect another in his place if the director was originally appointed by election.

Where the managing agent is empowered to appoint directors by the agency agreement, he can at any time remove a director appointed by him and appoint another in his place.—Sec. 377.

If a director is, by agreement or otherwise, entitled to receive compensation for premature termination of his services, he can enforce his claim notwithstanding the removal by resolution.—Sec. 284 (7) (a).

MANAGING DIRECTORS

Definition. The term Managing Director is defined in Section 2 (26) of the Act. The Managing Director is a director who is "entrusted

with any substantial powers of management". Such powers may be derived by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or by virtue of its memorandum or articles of association and which powers would not otherwise be exercisable by him. The power to do administrative acts of a routine nature when so authorised by the Board (e.g., the power to affix the common seal of the company or to draw and indorse any cheque etc.) shall not be deemed 'substantial powers of management'. The term Managing Director includes a director occupying the position of a managing director, by whatever name called.

Powers and Duties of a Managing Director. A Company may appoint a managing director (or a whole time director) to be in charge of the management of the affairs of the company. The powers and duties of a managing director are special in (i) the agreement with the company by which he is appointed or (ii) in the memorandum or articles of the company or (iii) in a resolution passed by the company in general meeting or by its Board of directors. Thus managing directors of different companies may have different powers and duties.

By the amending Act of 1960 it is provided that a managing director of a company shall exercise his powers subject to the superintendence, control and direction of its Board of directors.

Disqualifications of Managing Directors. No company shall, after the commencement of this Act, appoint or employ, or continue the appointment or employment of any person as its managing or whole-time Director who—

(a) is an undischarged insolvent, or has at any time been adjudged an insolvent;

(b) suspends, or has at any time suspended, payment to his creditors, or makes, or has at any time made, a composition with them; or

(c) is, or has at any time been, convicted by a Court of an offence involving moral turpitude.—Sec. 267.

Appointment of Managing Director and Whole-time Director. The following rules are applicable to a public company and a private company which is a subsidiary of a public company:

(i) The appointment of a person for the first time as a managing or whole-time director shall not have any effect unless approved by the Central Government. A company incorporated after the commencement of the Companies (Amendment) Act, 1960, may make such an appointment (without the approval of the Central Govern-

ment) but such appointment shall cease to have effect after the expiry of three months from the date of such incorporation unless the appointment has been approved by that Government.—Sec. 269 (1).

(ii) In the case of an existing company, the re-appointment of a person as a managing or whole-time director for the first time after the commencement of the amending Act of 1960, shall not have any effect unless approved by the Central Government.—Sec. 269 (2).

(iii) The rules relating to the appointment or reappointment of managing or whole-time directors cannot be amended without the approval of the Central Government.—Sec. 268.

Number of Managing Directorship. No person can ordinarily be managing director of more than *one* public company or private company which is a subsidiary of a public company. He can be managing director of *two* such companies if the second appointment is approved by a resolution of the Board of directors with the consent of *all* the directors present in a meeting of which specific notice was given to all the directors present in India. No person can be managing director of more than two companies. But the Central Government may, by a special order, allow a person to be managing director of more than two such companies where it is satisfied that the Companies should, for their proper working, function as a single unit and have a common managing director. A person may be managing director of more than two companies where the companies are private companies not subsidiaries of public companies.—Sec. 316.

Term of Office. No person can be appointed managing director for a term exceeding five years at a time. There is, however, no bar to the reappointment of a person after the expiry of his term of service.—Sec. 317. This section does not apply to a private company, unless it is a subsidiary of a public company.

LOANS TO DIRECTORS (AND FIRMS AND COMPANIES IN WHICH A DIRECTOR IS INTERESTED)

Without obtaining the previous approval of the Central Government, no company can, directly or indirectly, make any loan to, or give any guarantee or provide any security for,

(a) any director of the lending company or of a company which is its holding company or any partner or relative of any such director.

(b) any firm in which any such director or relative is a partner ;

(c) any private company of which any such director is a director or member ;

(d) any body corporate at a general meeting of which not less than twenty-five per cent of total voting power may be exercised or controlled by any such director, or by two or more such directors together, or

(e) any body corporate the Board of Directors, Managing Agents, Secretaries and Treasurers, or Manager whereof is accustomed to act in accordance with the directions or instructions of the Board or of any Director or Directors of the lending Company.—Sec. 295 (1).

Sec. 295 (2) provides that the above rules do not apply to any loan made, guarantee given or security provided—

(i) by a private Company unless it is a subsidiary of a public Company;

(ii) by a banking Company;

(iii) by a holding Company to its subsidiary; or

(iv) by a Company which is the Managing Agent or Secretaries and Treasurers of another Company to the latter.

The restrictions imposed by Section 295 apply to a transaction represented by a book debt which was from its inception in the nature of a loan or an advance.—Sec. 296.

Every person, including the director to whom the loan is given, who knowingly contravenes the rules mentioned above, may be punished by simple imprisonment up to six months and fine up to Rs. 5000. All persons who are knowingly parties to the contravention, are liable to make good the amount which the company paid on account of the loan, guarantee or security.

CONTRACTS IN WHICH A DIRECTOR IS INTERESTED

A director or his relative or a firm in which he is partner or a private Company in which he is member or director, shall not enter into contracts with the Company for the sale, purchase or supply of goods and services or for underwriting the subscription of its shares or debentures, *except with the consent of the Board of directors.*—Sec. 297 (1).

The above rule does not apply to the following cases :

(a) contracts for the purchase and sale of goods and materials for cash at prevailing market prices;

(b) contracts for the sale, purchase or supply of goods, materials and services in which either of the parties regularly trades or does business, provided the value of the goods etc. does not exceed Rs. 5000 in any year; and

(c) any transaction of a banking or insurance company in the ordinary course of business.—Sec. 297 (2).

In circumstances of urgent necessity a contract may be entered into *without the prior consent* of the Board, but such consent must be obtained within 3 months of the date on which the contract was entered into.—Sec. 297 (3).

The consent of the Board of directors is to be given by a resolution passed in a meeting.—Sec. 297 (4).

If consent is not given, anything done in pursuance of the contract shall be voidable at the option of the Board of directors.—Sec. 297 (5).

Every director who is in any way concerned or interested in a contract by or on behalf of a Company shall disclose the nature of his interest at a meeting of the Board of directors.—Sec. 299.

No director of a Company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement; nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote; and if he does vote his vote shall be void.—Sec. 300 (1).

The bar imposed upon participation in the Board's discussion does not apply in the case of a private Company which is not a subsidiary or a holding Company of a public Company, and in certain other cases.—Sec. 300 (2).

Every Company must maintain one or more registers in which shall be entered particulars of all contracts entered into by the Company, in which any of the directors are interested (except contracts not exceeding Rs. 1000 in value and the ordinary transactions of banking and insurance companies).—Sec. 301.

When a director has an interest in a contract by which a Manager, Managing Director, Managing Agent or Secretaries and Treasurers are appointed, the Company must send to every member of the Company an abstract of the contract, together with a statement clearly specifying the nature of the director's interest.—Sec. 302.

REGISTER OF DIRECTORS, MANAGING AGENTS ETC.

Every Company shall keep at its registered office, registers containing particulars about its Directors, Managing Agents, Secretaries and Treasurers, Manager and Secretary.—Sec. 303.

Copies of the particulars entered in the aforesaid registers shall be sent to the Registrar, who shall keep similar registers.

All the registers can be inspected by any person.

The Company must also maintain a register showing the number of shares and debentures (of the Company, its subsidiaries and its holding Company) held by every director, the managing agents, secretaries and treasurers and managers.—Sec. 307. Such persons must also disclose to the Company their shareholdings in the Company.—Sec. 308.

REMUNERATION OF DIRECTORS

The remuneration payable to the directors of a Company shall be determined either by the articles, or by a resolution passed in a general meeting of the members. The articles may require the resolution to be a special resolution.—Sec. 309 (1).

Rules regarding director's remuneration :

1. The remuneration of directors is part of the overall managerial remuneration which, according to Section 198, cannot exceed 11% of the net profits or Rs. 50,000 in certain exceptional cases.

2. A director may receive remuneration by way of a fee for each meeting of the Board, or a Committee thereof attended by him. (Where before the commencement of the amending Act of 1960, a director was paid on a monthly basis, the system may be continued up to two years after the commencement of the Act or the remainder of the term of the director, whichever is less).—Sec. 309 (2).

3. A director, who is either in the whole-time employment of the company or a Managing Director, may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other. But, except with the approval of the Central Government, such remuneration shall not exceed 5% of the net profits for one such director, and if there is more than one such director, 10% for all of them together.—Sec. 309 (3).

4. Directors (who are not in the whole-time employment of the company and not a Managing Director) may be allowed, by a special resolution, commission at a percentage of net profits which shall not exceed for all the directors together (i) 1% where the company has a managing agent, secretaries and treasurers or manager, and (ii) 3% in any other case. Commissions, in excess of these rates, may be allowed with the approval of the Central Government if so resolved in a general meeting of the company.—Sec. 309 (4).

5. The net profits are to be calculated in the manner laid down in Section 198 (1).—Sec. 309 (5).

6. Remuneration drawn in excess of what is allowable, must be refunded to the company and, till so refunded, must be held in trust for the company.—Sec. 309 (5A). The company cannot waive recovery of such sums.—Sec. 309 (5B).

7. A whole-time director or a Managing Director who receives a commission from a Company is not entitled to receive any commission or remuneration from any subsidiary of the Company.—Sec. 309 (6).

8. The rules stated above apply only to public Companies and private Companies which are subsidiaries of public Companies.—Sec. 309 (9).

9. Any provision relating to the remuneration of directors or an amendment thereof, whereby such remuneration is increased, will not be valid unless sanctioned by the Central Government.—Sections 310, 311.

The remuneration payable to directors is a debt for which a director may sue the Company. Such remuneration may be paid out of capital if there are no profits. *Re Lundy Granite Co.*²

Directors are not entitled to any remuneration as of right. They become entitled to remuneration when the articles so provide or when a resolution is passed by the members granting them remuneration. *George Newman & Co.*³

MEETINGS OF THE BOARD OF DIRECTORS

The Board of directors is the executive authority of the Company. Generally, the directors exercise their powers through resolutions passed in meetings of the Board. The Companies Act contains the following rules regarding Board meetings :

1. In the case of every Company, a meeting of its Board of directors shall be held at least once in every three calendar months. Not more than two months shall intervene between the last day of the calendar month in which such meeting is held and the date of the next meeting. The Central Government may, by notification in the official Gazette, exempt any class of companies from this rule either wholly or subject to modifications and conditions.—Sec. 285.

2. Notice of every meeting of the Board of directors shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.—Sec. 286.

² 26 L. J. 673

³ (1895) 1 Ch. 674

3. The quorum for a meeting of the Board of directors shall be one-third of its total strength (any fraction contained in that one-third being rounded off as one), or two directors, whichever is higher.

But when some directors are unable to participate in the discussions of the Board (because some contract or arrangement in which they are interested is being discussed) and the number of such directors exceeds or is equal to two-thirds of the total strength, the number of the remaining directors, that is to say, the number of the directors who are not interested, and are present at the meeting being not less than two, shall be the quorum during such time.—Sec. 287.

4. If a meeting of the Board could not be held for want of quorum, then unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.—Sec. 288.

A meeting, which could not be held for want of quorum, will count as a meeting for the purposes of Section 285. [Sec. 1. above.]

5. No resolution shall be deemed to have been duly passed by the Board or by a Committee thereof by circulation, unless the resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or to all the members of the Committee then in India (not being less in number than the quorum fixed for a meeting of the Board or Committee, as the case may be), and to all other directors or members, at their usual address in India and has been approved by such of the directors as are then in India, or by a majority of such of them, as are entitled to vote on the resolution.—Sec. 289.

POSITION OF DIRECTORS

There has been considerable discussion about the legal position of directors. They have been described sometimes as *trustees* of the company and sometimes as its *agents*. Neither view is wholly correct but both contain elements of truth.

A director is not a trustee in the correct legal sense of the term. A trustee is a person who is the owner of property and deals with it as principal. A director is not the owner of the company nor does he enter into contracts with third parties, as owner of the company's properties. Therefore a director is not a trustee. But the director's position is *similar* to that of a trustee because the directors are bound to exercise their powers in the interest of the company and are liable

for misuse of powers if any. A director may be called trustee in the sense that the courts expect from directors the same degree of integrity and standard of conduct as is expected from a trustee.

It is generally agreed that the directors occupy a fiduciary position in relation to the company. They cannot make secret profits and must make full disclosure of all material facts concerning their interests in connection with the company. There is, however, no fiduciary relationship between a director and an individual shareholder and he is not a trustee for any particular shareholder.

It is more accurate to describe directors as agents. The directors are agents of the company because the company acts through the directors. Contracts with third parties are entered into by the directors, not as principals, but as agents of the company. But it is not strictly speaking true to say that the directors are nothing more than agents of the company. By the articles and under the Companies Act the directors have independent powers in certain matters. An agent is bound to take instructions from his principal and to abide by his wishes in the business of the agency. But the directors are not bound to consult the shareholders in all matters. Greer L. J. explains the position in these words: "A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors; certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers."

Jessel M. R. described the position of the directors as follows: "Directors are described as trustees, agents or managing partners, not as exhausting their powers and responsibilities but as indicating useful points of view. It does not matter much what you call them, so long as you understand what their true position is, which is that they are commercial men, managing a trading concern for the benefit of themselves and all other shareholders in it." *Re. Forest of Dean Coal Mining Co.*⁴

POWERS OF DIRECTORS

Directors derive their power and authority from two sources (i) the Articles of Association of the Company and (ii) the Companies Act.

The articles of association generally contain a list of the powers which may be exercised by directors and the limitations on those

⁴ (1878) 10 Ch. D. 450

powers, if any. The articles also contain a list of those matters which are to be decided by the members in a general meeting. Section 291 of the Companies Act lays down that subject to the provisions of the articles, the Board of directors of a company shall be entitled to exercise all such powers and do all such acts and things as the company is authorised to exercise and do.

All acts and things done by the Board of directors, within the powers given to it by the articles, are valid and binding on the company. If the Board does something which is beyond the powers of the Board but within the powers of the company as laid down in the Memo, the members can, if they wish, ratify the act of the Board. The thing done will thereupon be binding on the company. But the members, even if unanimous, cannot ratify and validate an act which is beyond the powers of the company.

It is to be noted that a director individually has no authority over the affairs of the company except as regards matters which have been specifically delegated to him by the Board. Such delegation is permissible within certain limits. Apart from such delegated authority exercisable by individual directors, the authority and powers of directors are to be exercised collectively through resolutions of the Board of directors.

Section 292 of the Companies Act provides that the Board of directors shall exercise the following powers on behalf of the company and it shall do so only by resolutions passed at meeting of the Board:

(a) make calls on shareholders; (b) issue debentures; (c) borrow moneys otherwise than on debentures; (d) invest the funds of the company; and (e) make loans.

[Clauses (c) and (e) do not apply to banking companies.]

Some of these powers may be delegated to a committee of directors, or to the managing director, manager etc.

If for any reason the managing agents or the secretaries and treasurers of the company vacate their office, the Board of directors can carry on their functions until new ones are appointed.—Sec. 298.

Restrictions on the powers of the Board. Section 293 of the Act imposes the following restrictions on the powers of the Board.

The Board of directors of a public company or of a private company which is subsidiary of a public company shall not, except with the consent of the company in general meeting,—

(a) sell, lease or otherwise dispose of the whole, or substantially

the whole, of the undertaking of the company, or any of its undertakings where the company owns more than one undertaking ;

(b) remit or give time for the re-payment of any debt due by a director (except in the case of a loan by a banking company) ;

(c) invest otherwise than in trust securities the sale proceeds resulting from the acquisition, after the commencement of this Act, without the consent of the company, of any such undertaking as is referred to in clause (a), or of any premises or properties used for any such undertaking ;

(d) borrow moneys, where the moneys to be borrowed together with the moneys already borrowed by the Company, (apart from temporary loans obtained from the company's bankers in the ordinary course of business) will exceed the aggregate of the paid-up capital of the company and its free reserves, that is to say, reserves not set apart for any specific purpose ; or,

(e) contribute, after the commencement of this Act, to charitable and other funds not directly relating to the business of the company or the welfare of its employees, any amount the aggregate of which will, in any financial year, exceed twenty-five thousand rupees or five per cent of its average net profits during the three financial years immediately preceding, whichever is greater.

Section 293A (added by the amending Act of 1960) provides that no company can contribute, to any political party or to any individual or body for any political purpose, any sum exceeding Rs. 25,000 or 5% of its average net profits during the three immediately preceding years, whichever is greater. Any sum contributed for a political purpose must be disclosed in the profit and loss account.

Section 294 provides that after the commencement of the Act of 1956, the Board of directors of a company shall not appoint a sole selling agent for any area, except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in general meeting within a period of six months from the date on which the appointment is made.

Validity of Acts of Directors. Acts done by a person as director are valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or that his appointment as director had terminated by virtue of any provision contained in this Act or in the articles.—Sec. 290. It is, however, provided that nothing in Section 290 shall be deemed to give validity to acts done by a director after his appointment has been shown to the company to be invalid or to have terminated.

RIGHTS OF DIRECTORS

1. A director validly appointed to the Board, and not suffering from any disqualification which would prevent him from acting as such, is entitled to attend meetings of the Board and participate in the direction of the company's affairs. If this right is interfered with by the other directors or by the company's officers, it can be enforced by a mandamus from the High Court.

2. A director is entitled to receive the remuneration fixed by the articles or otherwise, subject to the provisions of the Act.

3. A whole-time director and a managing director may be given compensation by the company in case of premature termination of services. But no compensation can be given in the following cases—where the termination is due to reconstruction or amalgamation; where the director concerned has to vacate office in accordance with the provisions of the Act; where the company is being wound up; where the director is guilty of fraud or breach of trust; and where the director has instigated or has directly or indirectly taken part in bringing about the termination of his office. The amount of compensation paid must not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term of office or three years whichever is shorter.—Sections 318-321.

DUTIES OF DIRECTORS

The duties of directors of a company have been elaborately explained by Romer L. J. in *Re City Equitable Fire Insurance Co.*⁵

"The manner in which the work of a company is to be distributed between the board of directors and the staff is a business matter to be decided on business lines. The larger the business carried on by the company, the more numerous and the more important the matters, that must of necessity be left to the managers, the accountants and the rest of the staff.

"In ascertaining the duties of a director it is necessary to consider the nature of the company's business and the manner in which the work of the company is, reasonably in the circumstances and consistently with the articles, distributed between the directors and the other officials of the company.

"In discharging these duties a director,

(a) must act honestly,

(b) must exercise such degree of skill and diligence as would

⁵ (1925) 1 Ch. 407

amount to the reasonable care which an ordinary man might be expected to take in the circumstances on his own behalf ; but

(c) he need not exhibit in the performance of his duties a greater degree of skill than what can be reasonably expected from a person of his knowledge and experience ; in other words, he is not liable for mere errors of judgment ;

(d) he is not bound to give continuous attention to the affairs of his company ; his duties are of an intermittent nature to be performed at periodical board meetings and at meetings of any committee to which he is appointed, and though not bound to attend all such meetings, he ought to attend them when reasonably able to do so ; and

(e) in respect of all duties which, having regard to the exigencies of business and the articles of association, may properly be left to some other official, he is in the absence of suspicious grounds justified in trusting that official to perform such duties honestly."

If a director fails to perform his duties, as explained above, he is guilty of negligence. If on account of such negligence the company suffers any damage, the director must compensate the company.

The director's duty of disclosure : The Companies Act of 1956 makes it obligatory upon directors to disclose certain facts to the company.

1. He must disclose his age to the company.—Sec. 282.
2. If a director is interested in any contract or arrangement proposed to be entered into by the company, he must disclose the interest to the board of directors.—Sec. 299.
3. He must disclose, for the purpose of entry in the register of directors his name, address, occupation, nationality and certain other particulars.—Sections 303 and 305.
4. He must disclose the number of shares of the company which he holds.—Sec. 308.

DISABILITIES OF DIRECTORS

The Companies Act imposes certain disabilities on directors, with a view to protect the interests of the company and of the shareholders. A list of the disabilities is given below.

1. A director cannot assign his office.—Sec. 312.
2. Any provision (contained in the articles or in any other document) for exempting any officer of the company or its auditor from any liability for negligence, misfeasance, default, breach of duty

or breach of trust in relation to the company, or indemnifying him against such liability is void.—Sec. 201. The company may, however, indemnify any such officer against any liability incurred for defending a civil or criminal proceedings in which judgment is given in his favour.

3. There are restrictions on the giving of loans to directors and upon contracts with directors. (See *ante*).

4. *Office or place of profit*: (Sec. 314). An office or place of profit means any post that carries with it any remuneration or any perquisite in the form of rent-free quarters or otherwise.

Subject to the exceptions noted below, an office or place of profit under a company or its subsidiary cannot be held by a director of the company. Also, a director's partner or relative, a firm of which the director or his relative is a partner, a private company of which the director is a director or member and all directors, managing agents, managers, secretaries, and treasurers of such private companies, cannot hold an office or place of profit carrying a total monthly remuneration of Rs. 500 or more.

Exceptions :

(a) The office or place of profit can be held if the previous assent of the company has been accorded by a special resolution.

(b) The office or place of profit can be held in the subsidiary company, if the remuneration received is handed over to the company or its holding company.

(c) The following posts are not considered to be offices or places of profit for the purposes of this rule—the post of the managing director, managing agents, secretaries and treasurers, manager, legal or technical adviser, and banker or trustee for debenture holders of the company.

(d) The relative of a director may hold an office or place of profit if he was appointed before the director became a director.

A director contravening the aforesaid provisions shall be deemed to have vacated his office as director with effect from the first day on which the contravention occurs. He shall also be liable to refund to the company the remuneration received and the money equivalent of the advantages enjoyed by him in respect of the office or place of profit.

LIABILITIES OF DIRECTORS

The memorandum of association of a company may provide that the liability of the directors shall be unlimited.—Sec. 322.

A limited company may, if so authorised by its articles, alter its memorandum of association by special resolution so as to render unlimited the liabilities of its directors or any director or of its managing agents, secretaries and treasurers, or manager.—Sec. 323.

The directors may, under certain circumstances, be liable to pay compensation to the company and to outsiders. Some of these circumstances are mentioned below.

1. The directors are liable for untrue statements in the prospectus.

2. For contracts entered into on behalf of the company, the directors are not personally liable. But if the authority possessed by the directors is exceeded, they may be liable to pay damage to the other party for breach of warranty of authority.

3. The directors are liable to the company for *ultra vires* acts. For example, if dividend is paid out of capital, the directors are bound to refund the money to the company out of their own pockets.

4. If a director performs his duties negligently and the company thereby suffers damage, he must pay compensation to the company.

5. A director is liable to account for all secret profits made by him in connection with the affairs of the company.

6. A director is liable for any act amounting to a breach of trust relating to the properties and funds of the company.

7. Directors are liable for misfeasance i.e. any breach of duty which causes loss to the company.

8. For certain breaches of duty the Companies Act imposes a criminal liability upon directors. Various sections of the Act provides for the imposition of fines for non-performance of the prescribed duties. There is provision for imprisonment in certain cases.

Section 633 of the Act provides that in any proceedings against any director or officer of the company for negligence, breach of duty, misfeasance etc. the court can excuse him from any liability if it is of opinion that such director or officer has acted honestly and reasonably and that having regard to all the circumstances of the case, he ought fairly be excused. But in criminal proceedings, the court has no power to grant relief from any civil liability.

Offences against the Act are cognizable only upon a complaint in writing by the Registrar, a shareholder, or of a person authorised by the Central Government in that behalf.—Sec. 621. But if a shareholder makes a frivolous or vexatious complaint and any of the

accused is acquitted or discharged, the magistrate may direct the complainant to pay compensation. The magistrate may further order that if default is made in the payment of compensation, the complainant shall suffer simple imprisonment for a term not exceeding two months.—Sec. 625.

EXERCISES

1. What is the legal position of the directors in a joint stock company? (C.U. '47, '55)
2. "Directors of a company are not only agents, but they are also in some sense and to some extent trustees or in the position of trustees."—Discuss. (C.A., Nov. '50)
3. State how the Managing Director of a Public Limited Company is appointed and what his duties are. (C.U. '60)
4. How and by whom are the Directors of a company appointed? What are the restrictions imposed by the Companies Act on the powers of directors? (C.A. Nov. '59)
5. State briefly the provisions of the Companies Act pertaining to (i) the removal of a director, and (ii) the age limit applicable to a director. (C.A. May '61)

CHAPTER 7

MANAGING AGENTS, SECRETARIES AND TREASURERS, MANAGERS

MODES OF MANAGEMENT OF A COMPANY

The usual and normal practice is to entrust the management of a company to the Board of Directors. The Companies Act, however, recognises and provides for the following alternative forms of management :

1. Management through managing directors or wholetime directors.
2. Management by managing agents according to an agreement entered into between the company and the managing agents.
3. Management by Secretaries and Treasurers working under the control of the Board of Directors.
4. Management by managers working under the direct control of the Board of Directors.

No company can have *at the same time* more than *one* of the following categories of managerial personnel: (a) managing director, (b) managing agent, (c) secretaries and treasurers, and (d) manager.—Sec. 197A.

THE MANAGING AGENCY SYSTEM

Managing Agent. Section 2 (25) defines a managing agent as an individual, firm or body corporate, entitled to the management of the whole, or substantially the whole, of the affairs of a company by virtue of an agreement with the company.

The agreement may be recorded in the memo or the articles or in a separate document.

The term managing agent includes any individual, firm or body corporate occupying the position of a managing agent, by whatever name called.

Associate of the Managing Agent. Section 2 (3) of the Act of 1956 introduces a new term viz., “associate of the managing agent”.

In the Act a long list is given of individuals, firms and companies coming within the definition of the term Associate. It includes partners and relatives of the managing agent, firms and companies where the managing agent holds a substantial interest and (where the managing agent is a company) the subsidiaries or the holding company

of such company and also the directors and managers of such companies and their relatives.

Many of the restrictions imposed upon managing agents are applicable to associates of managing agents.

Effects of Managing Agency. Managing Agency is a system peculiar to India. It became popular during the latter part of the 19th century. The characteristic feature of the system is that the person, firm or company who is appointed managing agents, takes full charge of the management of the company. Although in theory the managing agents are supposed to act under the general control and direction of the Board of Directors of the managed company, in practice the agents have complete control of the company and very often utilise their powers for their personal benefit. The Act of 1913 contained certain provisions regarding managing agents but they were ineffective. The amending acts of 1936 and 1951 introduced certain rules intended to restrict the powers of the managing agents and thereby prevent the abuses of the managing agency system. But these rules were also not found to be adequate. The Act of 1956 provides for further restrictions. It is now specifically laid down that the managing agents are to act under the control and direction of the Board of the managed company. Managing Agents can be removed by ordinary resolution in certain cases. There can be no permanent managing agency as was possible under the Act of 1913.

RULES REGARDING THE APPOINTMENT OF MANAGING AGENTS

Prior to the commencement of the Companies Act of 1956, managing agents could be appointed by agreement either at the time of formation of the company or any time afterwards. The terms of the agency agreement were usually incorporated in the memo and the articles.

The Act of 1956 provides, by Section 326, that after the commencement of the Act a managing agent shall not be appointed or reappointed (a) except by the company in general meeting and (b) unless the approval of the Central Government has been obtained for such appointment or reappointment. The section further lays down that the Central Government shall not accord its approval unless it is satisfied that (i) it is not against the public interest to allow the company to have a managing agent; (ii) the managing agent proposed is a fit and proper person to be appointed or reappointed as such; (iii) the conditions of the managing agency agreement proposed are fair and reasonable; and (iv) the managing agent proposed has

fulfilled any conditions which the Central Government required him to fulfil.

Section 325A provides that a subsidiary company cannot be appointed managing agent of any company (unless immediately before the commencement of the amending Act of 1960 it had such a company as its managing agents).

CASES WHERE A MANAGING AGENT CANNOT BE APPOINTED

1. Section 324 of the Act provides that the Central Government may by notification in the official Gazette prohibit the appointment of managing agents in specified classes of industries or business. Upon such a notification being issued all existing managing agencies, in companies coming within the specified classes of industries and business, shall terminate within three years of the date of the notification or 15th August 1960, whichever is later. In case the agency is terminable (by the agency agreement) on a date earlier than either of the two dates mentioned above, the company shall not appoint or re-appoint any managing agent for the remaining period.

2. A company acting as managing agent, cannot itself be managed by a managing agent.—Sec. 325.

3. A company cannot have both Managing Agents and Secretaries and Treasurers. Therefore, when a company is managed by Secretaries and Treasurers, it cannot appoint a Managing Agent without first terminating the services of the former.

4. A Government Company cannot appoint a managing agent. But when a company becomes a Government Company after 1st April, 1956, and it has a managing agent appointed before the amending Act of 1960, it may continue the employment of the managing agent.—Sec. 618.

5. A banking company or an insurance company cannot be managed by managing agents.

VARIATION OF MANAGING AGENCY AGREEMENT

A resolution of the company in general meeting shall be required for varying the terms of a managing agency agreement ; and before such a resolution is passed, the sanction of the Central Government shall have to be obtained.—Sec. 329.

TERM OF OFFICE OF MANAGING AGENT

At present, no company can,

(a) in case it appoints a managing agent for the first time, make the appointment for a term exceeding ten years ;

(b) in any other case, reappoint or appoint a managing agent for a term exceeding five years at a time; and

(c) reappoint a managing agent for a fresh term, when the existing term of the managing agent has two years or more to run. (But the Central Government may permit reappointment at an earlier time if satisfied that it is in the interest of the company so to do).—Sec. 328 (1).

Any appointment or reappointment of a managing agent made in contravention of the aforesaid rules is void for the entire term of the appointment or reappointment.—Sec. 328 (3).

All existing managing agencies must terminate on 15th August 1960, unless extended according to the provisions of the Act.—Sec. 330.

The rules stated above, apply to all companies. But the Central Government may by a general or special order exempt a private company, which is not a subsidiary to a public company, from the operation of these rules.—Sec. 327.

VACATION OF OFFICE BY MANAGING AGENT

Sections 334 and 336 provide that the managing agent of a company shall be deemed to have vacated his office under the following circumstances :

1. In case the managing agent is an individual, if he is adjudicated an insolvent, or applies to be adjudicated an insolvent.
- 2. If the managing agency is a firm, upon the dissolution of the firm for any cause.
3. If the managing agent is a company, upon the winding up of the company.
4. If the managed company is wound up for any reason.
5. If the managing agent or any partner of a firm of managing agents or a director of the company which is managing agent or any person holding a general power of attorney from such company, is convicted of any offence and sentenced to imprisonment for a period of not less than six months.

In case of adjudication as an insolvent and conviction for any offence, the managing agent must vacate office within 30 days from the date of the order or if an appeal or a petition is filed against the order, within 7 days of the disposal of such appeal or petition. In case of firms or companies acting as managing agents, if the convicted partner or director is expelled from the firm or removed from the

post of director within 30 days of the sentence, the conviction will not involve vacation of the office of managing agency.

REMOVAL OF MANAGING AGENT FROM OFFICE

Section 337 provides that a company in general meeting may, *by ordinary resolution*, remove its managing agents from office in the following cases :

1. If the managing agent commits fraud or breach of trust in relation to the affairs of the company or its subsidiary or holding company.

2. If the managing agent has been found guilty of fraud or breach of trust in connection with the affairs of any company, by a court of law in India or outside.

3. If a partner of the firm of managing agents or a director of the managing agency company is found guilty of fraud or breach of trust in relation to the affairs of the company or its subsidiary or holding company.

Section 338 provides that a company in general meeting may, *by special resolution*, remove its managing agents from office for gross negligence in or gross mismanagement of the affairs of the company or any of its subsidiaries.

A general meeting to consider a resolution for the removal of a managing agent under the aforesaid provisions can be called by any two directors of the company. A copy of the resolution must be sent to the managing agents. The managing agent has the right of making a representation to the company about the resolution and of having the representation circulated to the members or read out in the meeting. They shall also be allowed to speak on the resolution in the meeting.—Sec. 339.

CHANGES IN THE CONSTITUTION OF THE MANAGING AGENT

Section 346 of the Act provides that where the managing agent of a public company or of a private subsidiary of a public company, is a firm or a body corporate, and a change occurs in the constitution of the agency firm or company, *the managing agent shall cease to act as such* on the expiry of six months from the date of the change or such further time as the Central Government may allow, unless the Central Government approves of the changed constitution, *before the expiry of the period mentioned above.*

The following changes are deemed to be changes in the constitution :

(a) Conversion from a public to a private company or *vice versa*.

(b) Any change among the directors or managers of the company whether caused by death, retirement, new appointment or otherwise.

(c) Any change in the ownership of the shares or in the membership.

Exception : Where the managing agent is a company whose shares are dealt in or quoted by a recognised stock exchange, changes in the ownership of shares shall not be considered to be a change in the constitution, unless the Central Government by notification in the official Gazette otherwise directs. The Central Government will issue such a notification if it is of opinion that any change in the ownership of shares which has taken place or is likely to take place will affect prejudicially the affairs of the managed company.

SUSPENSION OF MANAGING AGENTS

The managing agent shall be deemed to be suspended from his office as such, if a receiver is appointed for his property by a court or by or on behalf of the creditors of the managing agents.—Sec. 335.

RESIGNATION OF OFFICE BY MANAGING AGENT

~~Unless~~ Unless the managing agency agreement otherwise provides, a managing agent may, by notice to the Board, resign his office with effect from a specified date. Such resignation is not effective until it is accepted by the company. Upon receipt of such notice, the Board shall require the managing agent to prepare a statement of affairs of the company together with a balance sheet and profit and loss account (for the period commencing from the last accounting date to the date of resignation). If the managing agent does not do so, the Board shall itself prepare such a report. It shall also get a report from the auditors. The reports are to be placed before a general meeting of the company. The company in the general meeting may accept the resignation or take such action thereon as it deems fit.—Sec. 342.

RIGHTS OF MANAGING AGENTS

1. The managing agents possess such rights and powers as are given to them under the agreement of agency subject to the provisions of the Act.

2. A managing agent whose office has been terminated according to the provisions of the Act, has a charge on the assets of the company in respect of all moneys due to him from the company at the date of such termination or which he may have to pay after the termination in respect of any obligation properly undertaken by him on behalf of the company. The managing agent's charge on the assets is subject to all other existing charges on the assets.—Sec. 333.

3. Upon termination of the agency, the managing agent and the company shall be entitled to enforce any claim or demand which each may have against the other, in respect of anything done or omitted to be done by either of them before the termination of agency.—Sec. 367.

4. *Compensation for loss of office.* (Sections 365 and 366). A managing agent may, under the terms of his appointment, be entitled to compensation for premature termination of services.

The compensation payable for loss of office shall not exceed the remuneration which the managing agent would have earned if he had been in office for the unexpired residue of his term or three years, whichever is less. No compensation is payable in the following cases :

(a) When the managing agent resigns his office for any reason, including reconstruction or amalgamation of the company.

(b) When the managing agent vacates his office according to the provisions of the Act.

(c) When the managing agent is deemed to have been suspended.

(d) When the managing agent is removed from office by resolution.

(e) When the managing agent has instigated or taken part in bringing about the termination of his services.

(f) If within twelve months of the termination of agency the winding up of the company commences and it is found that the assets are not sufficient to repay the share capital (including premiums) contributed by the members.

5. **The remuneration of managing agents.** Subject to certain limits laid down by the Act, the managing agent is entitled to receive the remuneration fixed under the agreement of agency. Section 348 provided that the remuneration paid to a managing agent shall not exceed 10% of the net profits earned in the year. Since November, 1959, the Central Government has limited the remuneration of managing agents on a sliding scale varying from 10% to 4% of the net profits. The lowest rate is applicable to net profits of more than Rs. 1 crore. Net profits for this purpose are to be calculated in the manner laid down in Section 349 and 350, as amended.

A remuneration in excess of 10% may be paid to the managing agent, if it is sanctioned by a special resolution of the members and is approved by the Central Government as being in the public interest.—Sec. 352.

The managing agent is not entitled to any office allowance, but he may be reimbursed in respect of any expenses incurred by him on behalf of the company and sanctioned by the Board or by the company in general meeting.—Sec. 354.

The remuneration of a managing agent is not to be paid until the accounts of the company have been audited and laid before the company in general meeting. But there may be an arrangement for the payment of the minimum remuneration by instalments during the year.—Sec. 353.

The rules regarding remuneration of managing agents stated above are applicable to public companies and private companies which are subsidiaries of public companies. In the case of other private companies, the amount and mode of payment of the managing agent's remuneration is to be determined by the agreement executed by the company with the managing agents.—Sec. 355.

If any managing agent or his associate receives any sum from the company, whether directly or indirectly, by way of remuneration, rebate, commission, expenses or otherwise, in excess of the limits laid down in the Act, he shall refund such sum to the company and until refund, hold it in trust for the company. The company shall not waive the recovery of such sum, unless permitted by the Central Government.—Sec. 363.

RESTRICTIONS ON MANAGING AGENTS

The Companies Act, 1956, imposes various restrictions on managing agents. The restrictions are summarised below.

1. There are certain restrictions on *the mode of appointment, term of office and the amount of remuneration* payable to the managing agent. They have been explained above.

2. **Number of Companies under the same managing agent.** (Sec. 332). No person can at the same time be managing agent of more than ten companies.

Each of the following persons are deemed to hold office as managing agent :

- (a) where the managing agent is a firm—every member of the firm.
- (b) where the managing agent is a company—each of its directors, the secretaries and treasurers and the manager. Also, in the

case of public companies—every member entitled to exercise not less than 10% of the voting power, and in the case of private companies—every member entitled to exercise not less than 5% of the voting power. The terms 'director' and 'member' in this paragraph include any person in accordance with whose directions or instructions any director or member is, in the opinion of the Central Government, accustomed to act.

For the purpose of calculating the number 10, the following companies are to be excluded—a private company which is neither a subsidiary nor a holding company of a public company; an unlimited company; an association not carrying on business for profit or which prohibits the payment of dividends.

3. Transfer of Office by Managing Agent. A transfer of his office by the managing agent, shall not take effect unless it is approved both by the company in general meeting and by the Central Government.—Sec. 343.

4. Assignment of or Charge on Remuneration. Any assignment of or charge on his remuneration or any part thereof, effected by a managing agent, shall not be binding on the company.—Sec. 364.

5. Managing Agency not to be Heritable. Agency agreements entered into after the commencement of the Act of 1956 cannot provide for succession to the office of managing agency by inheritance or devise (except in the case of private companies not subsidiaries to public companies). Sec. 344. In case of existing managing agencies which provide for succession by inheritance or devise, no person shall succeed to the office on the death of the holder thereof unless the Central Government considers the successor to be a fit and proper person to hold the office and accords its sanction to the succession.—Sec. 345. This provision does not apply to a private company which is not a subsidiary to a public company.

6. Declaration by Managing Agent. Every firm and private company which acts as the managing agent of a company must file a declaration stating particulars regarding its ownership, management, shareholding and other matters specified in schedule VIII to the Act. Every public company except those whose shares are dealt with or quoted in a recognised stock exchange must also file a similar declaration. The Central Government may by notification in the official Gazette require public companies whose shares are quoted in the stock exchanges, to file the declaration.—Sec. 347.

7. Commissions on Sales and Purchases. No managing agent and no associate of the managing agent, shall receive any commission or remuneration in respect of *sales of goods* made from the premises

where they are produced or from the office of the managing agent or any place in India. Under certain conditions, commission and remuneration may be charged for sales effected from any place outside India.—Sec. 356.

No managing agent and no associate of the managing agent shall receive any payment whatever from the company (except such expenses as are sanctioned by the Board or by resolution in a general meeting in respect of *purchase of goods* made on its behalf in India. For purchases made outside India, commission may be paid at a rate determined by a special resolution of the company, provided the agent or the associate maintains an independent office at such place which is not connected with the business of the managed company.—Sec. 358.

The company may, by resolution, authorise a managing agent to retain any commission which he may earn from a different company as the buying or selling agent of the latter provided the rates are not less favourable to the company than the market rates.—Sec. 359.

8. Contracts for Purchase and Sale with managed Company. If there is any contract for the purchase or sale of any movable or immovable property or services (other than the work of managing agency) or the underwriting of shares or debentures between the company and its managing agents, the contract must be approved by a special resolution of the company and the Central Government. The restrictions on the sale and purchase of property and services do not apply if either the company or the managing agent regularly trades in them and their value or cost does not exceed Rs. 5,000 in any year. Particulars regarding the contract must be entered in a separate register maintained for the purpose.—Sec. 360. Registers relating to commissions and contracts with managing agents shall be open to inspection by members of the company. They can also take copies if desired.—Sec. 362.

9. Control of Board of Directors over Managing Agent. The managing agent of a company, whether appointed before or after the commencement of the Act of 1956, shall exercise his powers subject to the superintendence, control and direction of the Board of Directors and subject also to the provisions of the memorandum and articles of the company and to the restrictions contained in schedule VII to the Act.—Sec. 368.

10. Restrictions on the Powers of Managing Agents. Schedule VII provides that the managing agents shall not exercise any of the following powers except after obtaining the previous approval of the Board of Directors :

(a) Power to appoint as officer or member of the staff any person on a remuneration exceeding the limits laid down by the Board, or any person who is a relative of the managing agent or a partner of the managing agency firm or who is a director or member of the private company which is the managing agent.

(b) Power to purchase capital assets of the company except where the purchase is within the limits prescribed by the Board.

(c) Power to sell the capital assets of the company except where the sale price is within the limits prescribed by the Board.

(d) Power to compound, or sanction the extension of time for the satisfaction or payment of any claim or demand of the company against the managing agent or any associate of the managing agent.

(e) Power to compound any claim or demand made against the company by the managing agent or any associate of the managing agent.

11. Loans to Managing Agents. No public company and no private company which is a subsidiary of a public company shall, directly or indirectly, make a loan to or give guarantee or security for its managing agent, and associate of the managing agent and any body corporate which the Central Government by order declares to be accustomed to act according to the directions or instruments of the managing agent or his associate. (Sec. 369). This provision does not apply to any credit given by the company to its managing agent for the purpose of facilitating the company's business and held by such agent in his own name in current accounts and not exceeding Rs. 20,000 or such lower figure as the directors may determine. This restriction does not also apply to a loan by a holding company to its subsidiary.

12. Loans to Companies under the same management. Subject to the exceptions noted below, loans, guarantees and securities cannot be given by one company to another if both are under the same management.—Sec. 370.

Exceptions :

(i) Such transactions may be entered into if previously authorised by a special resolution of the lending company.

(ii) The restriction does not apply to loans, guarantees and securities given by a holding company to its subsidiary ; by the managing agent or secretaries and treasurers to the company managed, and, by a banking company in the ordinary course of its business.

(iii) The restriction does not apply to a book debt, unless the transaction was from its inception in the nature of a loan.

Loans etc. coming under this section must be recorded by the lending company in a separate register. The register is open to inspection and extracts and copies thereof may be taken.

13. Investments in the same Group of Companies. A company cannot purchase the shares and debentures of another company if both are under the same management, except to the extent noted below : (Sec. 372).

A company can invest, in the manner aforesaid, in any other company within the same group, up to 10 per cent of the subscribed capital of the other company, provided such investment is sanctioned at a meeting of the Board of Directors of the investing company with the consent of all the directors present and entitled to vote. Notice of such resolution must be given to all directors. The aggregate investment of a company in other companies in the same group must not exceed 20 per cent of the subscribed capital of the investing company. The aggregate investment of a company in all other bodies corporate must not exceed 30 per cent of the subscribed capital of the investing company.

A company can invest more than the amounts mentioned above, if it is sanctioned by a resolution of the members of the investing company and approved by the Central Government.

The restrictions on investment, mentioned above do not apply to the following cases : investments by an investing company, *i.e.* one whose principal business is the purchase and sale of shares, debentures and other securities; investments by a banking or insurance company; a private company, unless it is a subsidiary of a public company; investments by a holding company in its subsidiary; investments by the managing agent or the secretaries and treasurers in a company managed by them, and investments in "rights" shares, *i.e.*, purchase of further issue of shares as provided in Section 81.

Particulars of all investments coming within Section 372 must be entered in a separate register which shall be open to inspection by all members of the company. Particulars of the investment shall also be included in the balance sheet.

14. Competition between Managing Agent and Managed Company. A managing agent shall not engage on his own account in any business which is of the same nature as, or directly competes with, the business of the managed company or any of its subsidiaries, unless such company by special resolution, permits him to do so. If a managing agent

carries on such a business in contravention of the aforesaid rule, he must hold all the profits and benefits obtained from such business in trust for the managed company or companies.—Sec. 375.

15. Reconstruction and Amalgamations. Any condition in the agency agreement prohibiting reconstruction or amalgamation of the company except on the continuance of the same managing agent, is not binding on the company.—Sec. 376.

16. Appointment of Directors. Where the managing agent is authorised under the agency agreement to nominate directors to the Board of the managed company, he can appoint not more than two directors, where the number of directors exceeds five and not more than one, where the number does not exceed five. If, for any reason, the number of directors is reduced to 5 or less, the managing agent shall choose which of the directors appointed by him shall continue in office. If no choice is made, all the directors appointed by him have to vacate their offices. The managing agent cannot be given the right to appoint the chairman of the Board of directors.—Sec. 377.

SECRETARIES AND TREASURERS

Management of a company by secretaries and treasurers is a form of management recognised by the Act of 1956. The term 'Secretaries and Treasurers' is defined by Section 2 (44) as, "any firm or body corporate (not being the managing agent) which, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole or substantially the whole of the affairs of a company; and includes any firm or body corporate occupying the position of secretaries and treasurers, by whatever name called, and whether under a contract of service or not."

There is considerable similarity between managing agents and Secretaries and Treasurers. Both are in charge of the management of the company and both are to act under the control and supervision of the Board of Directors of the managed company. The points of difference between the two are as follows :

1. Secretaries and Treasurers must be a firm or company, the managing agents may be an individual, a firm or a company.

2. The Central Government can by notification declare that managing agents cannot be appointed in a particular class of industry or business. There is no such provision as regards Secretaries and Treasurers.—Sections 324 and 380.

3. The terms of office of Secretaries and Treasurers did not terminate on 15th August 1960, as they did in the case of managing agents.—Sections 334 and 380.

4. There is no limit to the number of companies which can be managed by the same Secretaries and Treasurers. - A managing agent cannot ordinarily manage more than 10.—Sections 332 and 380.

5. Since November, 1959, a sliding scale has been adopted limiting the remuneration of Secretaries and Treasurers between 7½% and 3% of net profits. The lower percentages apply to higher net profits. There is a similar scale for managing agents varying between 10% and 4% of the net profits.—Sec. 381 and rules.

6. Secretaries and Treasurers cannot be given power to appoint directors of the managed companies.—Sec. 382.

7. Secretaries and Treasurers have no right *to sell* goods manufactured by the company or *to buy* goods and materials for the company, except to the extent to which they are authorised by the Board of Directors.—Sec. 383.

Apart from the points mentioned above, all the provisions of the Act relating to managing agents apply to Secretaries and Treasurers. Also, all provisions regarding persons connected or associated with managing agents shall apply to persons connected or associated with Secretaries and Treasurers.—Sec. 379.

The office of 'Secretaries and Treasurers' must not be confused with the office of the "Secretary" which most companies have.

THE SECRETARY

The Secretary is an officer of the company having specified duties. The administrative work in a company can be divided into two parts; management of the business and secretarial work. The latter includes maintenance of the books and registers required by the Companies Act, issue of share certificates, certification of shares, the recording of transfer of shares etc. The secretary is in charge of this branch of administration. His duties include, in addition to the items mentioned above—attending meetings of the company, drafting the minutes, issuing notices of meetings, and sending returns to the Registrar. In some companies the secretary is also in charge of the accounts.

Section 2 (45) defines a secretary as, "any individual, firm or body corporate appointed to perform the duties which may be performed by a secretary under this Act and any other purely ministerial or administrative duties." A secretary is a servant of the company and under the full control of the Board of Directors.

MANAGER

Definition. Section 2 (24) defines a Manager as an individual (not

being the managing agent) who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of the company. The term includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not.

Differences between Manager and Managing Agent. The points of difference between a Manager and a Managing Agent are enumerated below :

1. The Act defines a Manager as one who "has the management" of a company and the Managing Agent as one who "is entitled to the management" of a company. The Manager may be in charge of the management of a company but he may not have an agreement "entitling" him to the management. In the case of the Managing Agent, there is an agreement, "entitling" the managing agent to manage the company.

2. In the case of a public company and a private company which is a subsidiary of a public company, the manager must be an individual, but the managing agent may be an individual or a firm or a company.

3. The manager is a servant of the company and is under the continuous control of the Board. The managing agent derives his powers from the agreement with the company and can act independently in many matters.

4. The managing agent can, if so empowered under the agreement, appoint some of the directors of the Board. The manager never has such a power.

5. There are comparatively few provisions in the Act regarding managers. There are detailed provisions regarding managing agents.

Similarities between Manager and Managing Agent. Both the Manager and the Managing Agent are in charge of the management of a company. Both are under the supervision, control and direction of the Board of Directors.

Provisions of the Act regarding Managers. The Act of 1956 contains the following rules regarding Managers :

1. No company can employ a firm, a body corporate or an association as its manager.—Sec. 384.

2. No company can appoint or employ any person as its manager who—

- (a) is an undischarged insolvent, or has at any time within the preceding five years been adjudged an insolvent; or

- (b) suspends payment or makes a composition with his creditors, or has at any time within the preceding five years suspended payment or made a composition with his creditors; or
- (c) is, or has at any time within the preceding five years been convicted by a court in India of an offence involving moral turpitude.—Sec. 385(1).

The Central Government may by notification in the official Gazette remove the disqualification incurred by any person from the aforesaid causes either generally or in relation to any company or companies specified in the notification.—Sec. 385(2).

3. Ordinarily a person can be manager of one company only. He can be manager of two or more companies under the same conditions under which a person may be managing director of two or more companies. (Sec *ante*).—Sec. 386.

4. Subject to the overall limits laid down for managerial remuneration, a manager may be given remuneration either by way of monthly payments or by way of a specified percentage of net profits. Except with the approval of the Central Government such remuneration shall not exceed in the aggregate 5% of the net profits.—Sec. 387.

5. Any change in the regulations of the company or any agreement by which the remuneration of a manager is increased, requires the previous approval of the Central Government.—Sections 310, 311, 388.

6. A manager cannot be appointed for a term exceeding five years at a time.—Sections 317, 388.

7. The office of manager cannot be assigned.—Sections 312, 388.

Rules 3 to 7 above do not apply to a private company unless it is a subsidiary of a public company.—Sec. 388A.

EXERCISES

1. Write short notes on : (a) manager, (b) managing agent, (c) managing director, (d) secretaries and treasurers as in the Companies Act, 1956. (C.U. '58)

2. Discuss the provisions of the Companies Act, 1956, relating to (i) the appointment of managing agents and their term of office (ii) restrictions on the number of managing agencies and (iii) changes in the constitution of a managing agency firm or corporation. (C.A., Nov. '56)

3. Define the term Managing Agent. Distinguish between a Manager and a Managing Agent. Indicate briefly the restrictions imposed by the Companies Act on the powers of a Managing Agent. (C.A. Nov. '60)

CHAPTER 8

ACCOUNTS, AUDIT AND REGISTERS

ACCOUNT BOOKS

Section 209 of the Act provides that every company shall keep at its registered office proper books of account with respect to—

(a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(b) all sales and purchases of goods by the company;

(c) the assets and liabilities of the company.

The Board of Directors may keep the books at some other place in India but the address of such place must be notified to the Registrar.

Where a company has a branch office, whether in India or outside, proper summarised returns of such branch office made up to date at intervals of not more than three months are to be sent by the branch office to the registered office.

Books up to 8 years previous to the current year must be kept in good order.

The books of account must give a true and fair view of the state of affairs of the company and explain its transactions.

The books of account shall be open to inspection by any director during office hours. They may also be inspected by the Registrar or any officer authorised by the Central Government, if sufficient cause exists.

If the books of account are not properly kept, every person responsible can be fined up to Rs. 1,000, and imprisoned up to 6 months.

ANNUAL ACCOUNTS AND BALANCE SHEET

At every annual general meeting of the company, the Board of Directors shall lay before the company the balance sheet and the profit and loss account. In the case of companies not carrying on business for profit there shall be an income and expenditure account instead of the profit and loss account.

The period for which the profit and loss account shall be made shall be as follows :

(a) In the first annual general meeting—from the date of incorporation of the company to a date not later than nine months previous to the date of the meeting.

(b) In the case of any subsequent annual general meeting—from

the date immediately after the date of the last accounts to a date not later than six months previous to the date of the meeting.

(c) The period of accounts, which is called the financial year of the company, may be less or more than a calendar year but it shall not exceed 15 months. With the special permission of the Registrar, it may extend to 18 months.

Failure to comply with the aforesaid rules may be punished with fine and also imprisonment, if the default is wilfully made.—Sec. 210.

Form and contents of Balance Sheet. Every balance sheet of a company shall give a true and fair view of the state of affairs of the company, as at the end of the financial year and shall be in the form set out in Part I of Schedule VI to the Act, or as near thereto as circumstances admit or in such other form as the Central Government may approve.—Sec. 211. Separate forms have been prescribed for banking and insurance companies.

Profit and Loss Account. The profit and loss account shall be prepared in the manner set out in Part II of Schedule VI to the Act and must contain the details mentioned there.

Every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

The form, set out in Part II of Schedule VI, does not apply to any insurance or banking company, or to any other class of company for which a form of profit and loss account has been specified in or under any Act governing such class of company.

The Central Government may, by notification in the Official Gazette, exempt any class of companies from compliance with any of the requirements in Schedule VI (form of Balance Sheet and requirements of the Profit and Loss Account) if, in its opinion, it is necessary to grant the exemption in the public interest.

Authentication—The balance sheet and the profit and loss account of a company must be signed on behalf of the Board by the managing agent, secretaries and treasurers, manager or secretary if any and not less than two directors one of whom shall be the managing director where there is one. The documents must be approved by the Board before they are authenticated and before they are submitted before the auditors for their report.—Sec. 215.

The profit and loss account and the auditor's report must be annexed to the balance sheet.—Sec. 216.

It is a punishable offence to issue, circulate or publish the balance sheet before it is authenticated.—Sec. 218.

A copy of the balance sheet, including the profit and loss account

and the auditor's report must be sent to every member of the company at least 21 days before the date of the annual general meeting.—Sec. 219.

In the case of a public company, three copies of the balance sheet and the profit and loss account together with other documents required to be annexed to the balance sheet, signed by the managing agent, secretaries and treasurers, manager or secretary or by a director, shall be sent to the Registrar.

In the case of a private company, three copies of the balance sheet, certified to be true copies by the auditors of the company and of the auditor's report in so far as it relates to the balance sheet, are to be sent to the Registrar.—Sec. 220.

Certain companies (*e.g.* Banking and Insurance companies) are required to file a statement of assets and liabilities in the form prescribed in Table F.

BOARD'S REPORT

Section 217 provides that there shall be attached to every balance sheet laid before a company in general meeting, a report by its Board of directors, with respect to—

- (a) the state of the company's affairs;
- (b) the amounts, if any, which it proposes to carry to any reserves in such balance sheet;
- (c) the amount, if any, which it recommends should be paid, by way of dividend; and
- (d) material changes and commitments, if any, affecting the financial position of the company which have occurred between the last date covered by the balance sheet and the date of the Board's report.

The Board's report shall, (so far as is material for the appreciation of the state of the company's affairs by its members and will not in the Board's opinion be harmful to the business of the company or of any of its subsidiaries) deal with any changes which have occurred during the financial year—

- (a) in the nature of the company's business;
- (b) in the company's subsidiaries or in the nature of the business carried on by them; and
- (c) generally in the classes of business in which the company has an interest.

The Board shall also be bound to give the fullest information and explanation in its report, on every reservation, qualification or adverse remark contained in the auditors' report.

The Board's report and any addendum thereto shall be signed by its Chairman if he is authorised, in that behalf by the Board; and where he is not so authorised, shall be signed by such number of directors as are required to sign the balance-sheet and the profit and loss account of the company.

THE AUDITORS OF A COMPANY

Appointment of Auditors. (Sections 224, 225). The first auditors of a company shall be appointed by the Board of directors within one month of the date of registration of the company. The members at a general meeting may remove all or any of the first auditors so appointed, and appoint other persons. Notice of the nomination of any person proposed to be appointed as auditor must be given not less than 14 days before the date of the meeting. If the first auditors are not appointed by the Board, they may be appointed by the company in a general meeting. The first auditors hold office until the conclusion of the first annual general meeting. Thereafter, auditors are appointed at each general meeting to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

At any annual general meeting, a retiring auditor, by whatsoever authority constituted, shall be re-appointed, unless—

(a) he is not qualified for re-appointment;

(b) he has given the company notice in writing of his unwillingness to be re-appointed;

(c) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or

(d) where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all these persons, as the case may be, the resolution cannot be proceeded with.

The appointed auditor must, unless he is a retiring auditor, be informed within 7 days and he must, within 30 days, inform the Registrar whether he accepts or refuses the appointment.

Where at an annual general meeting no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy.

The company shall within seven days of the Central Government's power becoming exercisable, give notice of the fact to the Government.

Casual vacancies in the post of auditors may be filled by the Board till the next meeting, except vacancies caused by resignation which must be filled by the company in a general meeting. When there are several auditors and a vacancy occurs, the remaining auditors can continue to act as auditors.

Special notice shall be required for a resolution at a general meeting appointing as auditor a person other than a retiring auditor or providing expressly that a retiring auditor shall not be re-appointed. Notice of such resolution must be given to the auditor concerned and he may ask for the circulation of a representation regarding the matter to the members. If the representation is received too late for circulation, it may be read out at the meeting. The auditor shall also be heard at the meeting. The representation given by him will not be circulated if the Court, on an application made to it, is of opinion that the right conferred on the auditor is being abused to secure needless publicity for defamatory matter.

Removal of Auditors. The first auditors appointed by the Board can be removed by the company in a general meeting. In other cases, an auditor can be removed, before the expiry of his term by the company in a general meeting provided the previous approval of the Central Government is obtained in that behalf. Special notice of such a resolution must be given and the procedure laid down regarding the non-appointment of a retiring auditor must be followed. (See last para.)—Sections 224-225.

Qualifications and Disqualifications of Auditors. (Sec. 226). A person shall not be qualified for appointment as auditor of a company unless he is a chartered accountant within the meaning of the Chartered Accountants Act, 1949.

A firm whereof all the partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company, in which case any partner so practising may act in the name of the firm.

None of the following persons shall be qualified for appointment as auditor of a company—

- (a) a body corporate;
- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d) a person who is indebted to the company for an amount exceeding one thousand rupees or who has given any guarantee or provided any security in connection with the indebtedness of any third

person to the company for an amount exceeding one thousand rupees;

(e) a person who is a director or member of a private company, or a partner of a firm, which is the managing agent or the secretaries and treasurers of the company;

(f) a person who is a director, or the holder of shares exceeding five per cent in nominal value of the subscribed capital, of any body corporate which is the managing agent, or the secretaries and treasurers, of the company.

But any shares held by such person as nominee or trustee for any third person and in which the holder has no beneficial interest shall be excluded in computing the percentage of shares held by him for the purpose of this clause.

Rights and Powers of Auditors. Section 227 (1) of the Act provides that every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere, and shall be entitled to require from the officers of the company such information and explanation as the auditor may think necessary for the performance of his duties as auditor.

Section 231 provides that notice of all general meetings must be given to the auditors and they can attend and speak on all matters concerning them as auditors.

Any officer of the company who fails to comply with the rules mentioned above, may be fined up to Rs. 500.

Duties of Auditors. Section 227 (2) lays down the statutory duties of an auditor. They are as follows :

The auditors shall make a report to the members of the company on the accounts examined by him, and on every balance sheet and profit and loss account and on every other document declared by the Companies Act to be part of or annexed to the balance sheet or profit and loss account, which are laid before the company in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by this Act in the manner so required and give a true and fair view—

(i) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

(ii) in the case of the profit and loss account, of the profit or loss for its financial year.

The auditor's report shall also state—

(a) whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit;

(b) whether, in his opinion, proper books of accounts as required by law have been kept by the company so far as appears from his examination of these books, and proper returns adequate for the purpose of his audit have been received from branches not visited by him ;

(bb) whether the report on the accounts of any branch office audited under Sec. 228 by a person other than the company's auditor has been forwarded to him as required and how he has dealt with the same in preparing his report;

(c) whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

Where any of the matters referred to in clauses (i) and (ii) or in clauses (a), (b), (bb), and (c) above is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

The auditor's report must be signed by the auditor or a partner of the firm of auditors.—Sec. 229.

If any auditor's report is made, or any document is signed, otherwise than in conformity with the requirements of Secs. 227 and 229, the person concerned shall, if the default is wilful, be punished with fine which may extend to Rs. 1000.—Sec. 233.

Special Audit. The Central Government may direct special audit of a company's accounts of any period if it is of opinion that,

(a) its affairs are not being managed in accordance with sound business principles or prudent commercial practices; or

(b) it is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) its financial position is such as to endanger its solvency. —Sec. 233A.

Legal decisions on the duties and responsibilities of auditors. The duties and responsibilities of auditors have been discussed in a number of cases *e.g. Re Kingston Cotton Mills Co.*¹; *In re Republic of Bolivia Syndicate*,² *Re City Equitable Fire Insurance Co.*,³ *Registrar v. P. M. Hegde*,⁴ *Deputy Secretary v. S. N. Das Gupta*.⁵ The principles laid down in the aforesaid cases can be summarised as follows :

¹ (1896) 2 Ch. 279

² (1914) 1 Ch. 139

³ (1925) 1 Ch. 407

⁴ A.I.R. (1954) Mad. 1080

⁵ A.I.R. (1956) Cal. 414

An auditor is expected to know the provisions of the memo and the articles. "Auditors are in my opinion, bound to see what exceptional duties are cast upon them by the articles of the company which they are called upon to audit. Ignorance of the articles or of the exceptional duties enforced by them would not afford any legal justification for not observing them." Per Lindley L. J. in the case of *Kingston Cotton Mills Co.*

Whenever it is necessary to make any enquiry, the auditor must do it in the manner in which an expert in his position would consider it reasonable to make.

The auditor is bound to satisfy himself that the valuation of assets is reasonably accurate. Whenever he feels that the assets have been overvalued, it is his duty to say so in his report. There is no similar duty in case of undervaluation, because the directors are at liberty to undervalue the assets as a precautionary measure against future fluctuations in value.

The auditor must not confine himself to verifying the arithmetical accuracy of the balance sheet but must enquire into its substantial accuracy. *Leeds Estate and Building Co. v. Shepherd.*⁶

The auditor is not justified in omitting to make personal inspection of securities in the custody of the company or any person on its behalf. Whenever an auditor discovers that securities of a company are not in proper custody, it is his duty to require that the matter be put right at once.

The measure of an auditor's responsibility depends upon the terms of his engagement.

The auditor is not required to give advice to the directors regarding loans and investments. His duty is only to find out the true financial position of the company at the time of audit and to disclose it in his report.

The auditor is liable to pay damages if on account of his breach of the statutory duties or wrongful acts, the company suffers loss. The auditors are also responsible to persons who are misled by a false balance sheet which has been certified by the auditor as correct.

The auditor is criminally liable for any breach of his statutory duties, wilfully made.

EXERCISES

1. State and explain the statutory duties of the auditors of a company. (C.A., May '51).
2. What are the powers and duties of auditors of limited companies? (C.A. May '59).

⁶ (1887) 36 Ch. D. 787

CHAPTER 9

DIVIDENDS

DEFINITION OF DIVIDEND

The term Dividend means the part of profits which is paid to the shareholders of a company.

A trading company is formed for the purpose of earning profits. It can therefore be assumed that the profits will be distributed among the shareholders. The Act, however, contains no provision enforcing distribution of profits and no shareholder can claim the declaration of dividends unless the articles make it compulsory for the directors to declare dividends. How much of the profit is to be distributed as dividend, is a matter of internal management and the court will not interfere with the discretion of the directors and shareholders. *Burland v. Earle*.¹

RULES REGARDING DIVIDENDS

1. The Board of Directors of the company determines what portion of the net profits earned by the company during its financial year is to be distributed to the shareholders.

2. The amount or rate of dividend determined by the Board must be sanctioned by the members of the company in a general meeting. The members can reduce the amount determined by the Board but cannot increase it.

3. A part of the profits may be distributed before the accounts are finally passed and the declaration of dividends sanctioned in the general meeting. Such dividends are called Interim Dividends. An Interim Dividend means dividend paid between two ordinary general meetings of the shareholders of a company. Regulation 86 of Table A provides that the Board may from time to time pay to the members such *interim* dividends as appear to it to be justified by the profits of a company.

4. Dividends may be paid in proportion to the nominal value of the shares or in proportion to the capital actually paid up on each share, as the articles provide. If unequal amounts have been paid on the shares, the dividends may be unequal as among different shareholders.
—Sec. 93.

¹ (1902) A.C. 95

5. Dividend cannot be paid out of capital. It must be paid out of profits of that year or out of the profits of any previous financial year. "Profits" in this context means profits arrived at after providing for depreciation in the manner laid down in the Act. In companies, where the Central or the State Government has given a guarantee for the payment of a certain rate of dividend, any sum paid by the Government in fulfilment of the guarantee may be paid out as dividend.—Sec. 205.

6. Since dividends are to come out of profits, the rate of dividend recommended by the Board of directors will depend on (a) how the profit and loss accounts are made up; (b) the valuation of assets and the rate of depreciation; and (c) the percentage of profits transferred to the reserve fund of the company.

As regards item (a), the profit and loss accounts, the Companies Act contains certain rules which all companies must follow. As regards items (b) and (c) the directors have considerable discretion. In *Lee v. Neuchatel*² it was held that directors may distribute profits without making any provision for depreciation or reserves and without recouping loss of capital. But according to Section 205 of the Companies Act (as amended in 1960) depreciation must be provided for before dividends are paid. There is, however, one exception. The Central Government may, if it thinks necessary so to do in the public interest, allow any company to pay dividend for any year without providing for depreciation.

7. Dividends are payable in cash. But the capitalisation of profits (or reserves) by the issue of fully paid-up bonus shares or paying up any amount unpaid on any share, is permitted.

8. Any dividend payable in cash may be paid by cheque or warrant sent through the post.

9. Dividends are payable only to the registered shareholders, bearers of share warrants and their bankers.—Sec. 206.

10. The dividends must be distributed within 42 days after they are declared. Failure to do so is a punishable offence.—Sec. 207.

11. A dividend becomes a debt from the date on which it is declared and becomes payable. A shareholder, who is entitled to get it, can file a suit to recover it.

EXERCISE

1. What is dividend? State the rules regarding the payment of dividends by a public limited company.

² (1889) 41 Ch. D.1.

CHAPTER 10

BORROWING POWERS, DEBENTURES

BORROWING POWERS OF A COMPANY

Since the powers of a company are determined by the memorandum and the articles of association, whether a company can borrow money and if so to what extent, are matters depending upon the interpretation of these two documents. The Companies Act does not contain any section expressly empowering companies to borrow.

In some cases the memo and the articles provide that the company shall be entitled to borrow. Sometimes the power to borrow is given, subject to certain limitations. If so, the limitations must be strictly complied with. Borrowing in excess of the limits laid down or by methods not sanctioned, is *ultra vires* the company and not binding on it.

It has been held that a trading company has an implied power to borrow, because commercial transactions necessarily involve the giving and taking of credit. *General Auction Estate Co. v. Smith*.¹ A non-trading company has no implied powers to borrow. If the memo and the articles of such a company contain no provision empowering the company to borrow, they must be altered to give such power before the company can borrow.

Where the memo and the articles give the power to borrow, loans may be taken in any one or more of the following ways (unless any of them is prohibited): mortgage of immovable properties of the company; hypothecation or mortgage of movable goods, including stock in trade and, furniture; charge on uncalled capital; floating charge on all the assets of the company; mortgage of book debts; promissory notes, hundis and bills of exchange; debentures and debenture stock; charge on patents, licences and copyrights and goodwill.

A company cannot borrow money on the security of its books of account because such books are required to be kept in the registered office and they are open to inspection. Also, money cannot be borrowed on the security of the reserve capital.

DEBENTURES

The issue of debentures is a particular mode of borrowing money

¹ (1891) 3 Ch. 432

by companies. A debenture is a document which shows on the face of it, that the company has borrowed a certain sum of money from the holder thereof upon certain terms and conditions. A debenture is generally issued as a part of a series. Suppose that a company desires to borrow Rs. 10,000. It may issue 1000 debenture scrips or certificates of Rs. 10 each. The holder of each scrip is entitled to receive from the company the sum of Rs. 10 plus the interest thereon. Each debenture is numbered and contains a printed statement of the terms and conditions viz., the rate of interest, the time of payment of interest, the security against which the debenture is issued and what steps the debenture holder can take in case of non-payment of his dues.

Palmer defines a debenture as "any instrument under seal evidencing a deed, the essence of it being the admission of indebtedness". Section 2 (12) of the Companies Act states that a debenture, "includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not".

A debenture usually creates a floating charge on the assets of the company, i.e., a charge which is enforceable upon non-payment of the interest or principal on the due dates. A floating charge differs from a fixed charge in that it does not create any interest in the properties in question immediately. The company can deal with the properties in any way it likes in spite of the existence of the debentures. But the floating charge becomes a fixed charge, equivalent to a mortgage, upon the happening of the contingencies mentioned in the debentures (e.g. non-payment of interest) and upon winding up of the company.

A debenture may create a fixed charge instead of a floating charge. Sometimes debenture-holders are given the right to appoint a receiver in case of non-fulfilment of the terms of the debentures by the company. Sometimes a series of debentures are issued with a trust deed by which trustees are appointed to whom some or all the properties of the company are transferred by way of security for the debenture-holders.

CLASSIFICATION OF DEBENTURES

Debentures may be classified in different ways, some of which are mentioned below :

I. *Redeemable Debentures and Perpetual Debentures.* Section 120 of the Companies Act provides that debentures may be issued subject to the condition that they are irredeemable or redeemable only on the happening of a contingency, however remote, or on the

expiration of a period however long. Thus debentures may be either Redeemable or Perpetual.

II. The money due on the debentures may be *payable only to registered holders* or may be *payable to bearers*.

III. *Debenture and Debenture Stock*. The difference between Debenture and Debenture Stock is similar to the difference between shares and stock. A debenture is a document showing a particular debt. There may be a series of debentures. If the entire debt, covered by the debentures is treated as a single unit, it is called Debenture Stock. In the case of debenture stock, the company issues to each creditor a certificate showing what fraction of the entire debt is owed to him. The certificate is called the Debenture Stock Certificate.

RULES RELATING TO DEBENTURES

The Companies Act of 1956 lays down the following rules regarding debentures :

1. No debenture holder is to have any voting rights in company meetings.—Sec. 117. This applies to debentures issued after the commencement of the Act of 1956.

2. If there is a trust deed securing the issue of debentures, every debenture holder can have a copy of it on payment of a small fee.—Sec. 118.

3. The trustees in a trust deed securing the issue of debentures must exercise due care and diligence in the performance of their duties. Any provision in the deed exempting them from liability on this account is void.—Sec. 119.

4. Debentures may be irredeemable or redeemable on the happening of a contingency.—Sec. 120.

5. Redeemed debentures can be reissued, unless there is any provision to the contrary, whether express or implied, in the articles or in the conditions of the issue of the debentures or in any contract entered into by the company or when the company has passed a resolution to that effect.—Sec. 121.

6. An agreement to take a debenture can be specifically enforced.—Sec. 122.

7. Debts of the company, which by the Act receive preferential payment in case of winding up, shall have priority over the claims of the debenture holders. If, by virtue of the condition of the issue, the debenture holders have taken possession of the properties of the company or have appointed a receiver who has taken possession, the claims of the preferred creditors shall be paid forthwith out of any

assets coming into the hands of the receiver or other person on behalf of the debenture holders.—Sec. 123.

8. Full particulars regarding the issue of debentures in series must be sent to the Registrar.—Sec. 128. The particulars must include a statement of the commission paid.—Sec. 129.

9. There are certain limits on the amount of commission and brokerage that can be paid for the sale of debentures (See under 'Commission and Brokerage for the sale of Shares' in Ch. 4).

10. The rules relating to transfer of shares and share certificates (Sections 108-113) apply to debentures. (See *ante*).

11. **Register and Index of Debenture Holders.** Every company shall keep a Register of debenture holders, entering therein particulars regarding the name, address, and occupation of debenture holder and the dates on which the holding commenced or ceased.—Sec. 152 (1).

Every company having more than 50 debenture holders shall keep an Index of debenture holders unless the Register of debenture holders is itself kept in the form of an index.—Sec. 152 (2).

No notice of any trust, express, implied or constructive, shall be entered in the Register of debenture holders.—Sec. 153.

The Register of debenture holders may be closed for not more than 45 days in the year and not more than 30 days at a time, by giving at least 7 days' notice through a local newspaper.—Sec. 154.

There may be a Foreign Register of debenture holders analogous to the Foreign Register of members.—Sections 157 and 158.

RIGHTS OF DEBENTURE HOLDERS

If the Company fails to pay the interest or principal on the due date or fails to comply with any of the terms and conditions under which the debenture was issued, the debenture holder can adopt any of the following remedial measures :

1. He may file a suit for the recovery of the money by sale of the assets which were charged for the payment of the money.

2. He may file an application for the appointment of a receiver by the court.

3. He may himself appoint a receiver if the terms of the debenture entitle him to do so.

4. The trustees may sell the properties charged, if such a power is given to them under the terms of the debenture.

5. He may apply to the court for the foreclosure of the company's right to redeem the properties charged for the payment of the money.

6. He may present a petition for the winding up of the company.

DIFFERENCES BETWEEN SHAREHOLDERS AND DEBENTURE HOLDERS

1. A shareholder has a proprietary interest in the company. A debenture holder is only a creditor of the company.

2. A debenture holder is entitled to a fixed interest. A shareholder is entitled to dividends depending on and varying with the profits earned.

3. A shareholder has voting rights. A debenture holder, after 1956, cannot have voting rights.

4. Debentures may be redeemable. Shares (except preference shares under certain circumstances) are not redeemable. Under special circumstances the court may direct the purchase of shares by the company. (Section 397 and 398).

5. Debenture holders get priority over shareholders when assets are distributed upon winding up.

REGISTRATION OF MORTGAGES AND CHARGES

Section 125 of the Companies Act provides that all charges and mortgages of the kinds mentioned below, must be registered with the Registrar of Companies by filing with him all particulars concerning them together with a copy of the deed by which the charge or mortgage is created :

A charge for the purpose of securing debentures ; charge on uncalled share capital ; charge on any immovable property or any book debts ; charge, not being a pledge, of any movable property ; floating charges on the properties and stock in trade ; charges on calls, ship or share of ship, goodwill, patent or licence ; charges with which a property is purchased.

The charge must be registered within 21 days of its creation. (Seven days more if there is sufficient cause for the delay.)

The Registrar is to give a certificate of registration. All debentures must be endorsed with a copy of the certificate of registration. The registration may be effected by the company or by any person interested. Modification of the terms of the charge must be notified to the Registrar.

The company is to maintain a Register and Index of Charges. The Registrar also keeps a Register of Charges.

The company is to give intimation to the Registrar when a registrable charge or mortgage is satisfied by payment.—Sec. 138.

The court may excuse any omission in filing particulars etc. which was accidental or due to inadvertence. The Register may thereupon be rectified.—Sec. 141.

The Register and copies of instruments by which a charge is created may be inspected by members, creditors etc.—Sec. 144.

Consequences of failure to register charges. If a charge or mortgage is not registered in accordance with the aforesaid provisions, the following consequences ensue:

- (a) the charge becomes void as against other creditors and the liquidator in case of winding up (*i.e.* the charge holder loses priority);
- (b) the debt becomes immediately payable; and
- (c) the officers of the company concerned are liable to punishment.

EXERCISES

1. What do you understand by debentures. How do you distinguish between fixed charges and floating charges? What are the rights of the debenture holders? (C.U. '48)

2. Enumerate the mortgages and charges which have to be registered under the Indian Companies Act. Discuss the effects of non-registration. (C.A., Nov. '55)

CHAPTER 11

CONTROL OVER COMPANIES

THE ADMINISTRATION OF COMPANY LAW

The Companies Act of 1956 has enormously increased the functions of the Central Government in relation to companies. The object of the Act is to give to the Government such powers of control as would prevent malpractices and protect the interests of the investing public.

The most important official in connection with company law administration is the Registrar of Companies. In almost all the States there is a Registrar, appointed by the Central Government. In some States there are also Assistant, Deputy or Joint Registrars. There are four Regional Directors with headquarters at Calcutta, Bombay, Madras and Delhi. The state Registrars work under the Regional Directors who are under the appropriate ministry at Delhi. Since 1956, the office of the Registrars has been greatly expanded. Through the administrative organisation mentioned above, it is expected to secure co-ordination between the different offices of the Registrars and the Central Government and also to provide for a machinery through which the obligations and duties of the Government as regards company law may be carried out.

The Registrars have a number of important functions :

1. *The function of registration.* All important documents like the memo and the articles, mortgages and charges must be registered with the Registrar.
2. *The issue of certificates.* The Registrar issues the certificate of incorporation, certificate of the commencement of business etc.
3. *The enforcement of returns.* The companies are bound to send various kinds of returns and reports. It is the duty of the Registrar to see that the returns and reports are filed in time.
4. *Public information.* From the office of the Registrar members of the public can obtain inspection and copies of documents relating to companies.
5. *Prosecution of delinquent directors and company officials.* It is the duty of the Registrar to prosecute persons guilty of offences against the company law.

6. *Enquiry and investigation.* The Registrar can under certain circumstances enquire and investigate into the affairs of a company.

INVESTIGATION OF THE AFFAIRS OF A COMPANY

There are six different types of enquiries and investigations into the affairs of a company provided for by the Companies Act of 1956. They are briefly enumerated below :

I. **Special Audit.** Under certain circumstances the Central Government can direct a special audit of a company's accounts of any period.—Sec. 233A. (See Ch. 3.)

II. **The Registrar's Power of Enquiry.** (Sec. 234).

If on perusing a document which a company is bound to submit to him under the Act, the Registrar is of opinion that further information or explanation is necessary he may, by an order in writing, call upon the company to submit the same within a fixed date. If the company fails to submit the explanation or information by the due date, the company and every official concerned may be fined. The court can, on the application of the Registrar, direct the company to give inspection of any required document to the Registrar.

If the information or explanation is not given, or if upon perusal of the information and explanation given, the Registrar is of opinion that the document in question discloses an unsatisfactory state of things or that it does not disclose a full and fair statement concerning the matter, the Registrar shall make a report of the matter to the Central Government.

If it is represented to the Registrar on materials placed before him by a creditor, contributory or a person interested that the business of the company is being carried on fraudulently or unlawfully, he may after giving an opportunity to the company of being heard, direct the company to furnish any information or explanation on the matter. Thereafter the Registrar shall proceed with the matter as described above. If upon enquiry the Registrar is satisfied that the representation on which he took action was frivolous or vexatious, he will disclose the identity of the informant to the company. (The company can proceed against him for defamation etc.)

If the Registrar apprehends that the books and papers of a company may be destroyed, falsified or hidden, he may seize them after getting an order from a magistrate of the 1st class or a Presidency magistrate.—Sec. 234A.

III. **Investigation by Inspectors.** (Sections 235-246).

The Central Government may appoint one or more competent

persons as inspectors to investigate the affairs of any company and report thereon, under any of the following circumstances :

1. *On the application of a certain number of members of the company.* If the company is one having a share capital, the number of members applying must be at least 200 or members holding not less than one tenth of the total voting power. If the company does not have a share capital, the number of members applying must be not less than one-fifth of the total number of members. The application must be supported by evidence and the Government may require the applicant to give security for costs, not exceeding Rs. 1,000.

2. *On the report of the Registrar.* If the answer to an enquiry by the Registrar under Section 234, is considered to be unsatisfactory, he is to report to the Central Government. On his report the Central Government may appoint inspectors.

3. If the company passes a special resolution for such investigation.

4. If the court declares that the affairs of the company should be so investigated.

5. If the Central Government is of opinion that (i) the company is being conducted fraudulently or unlawfully or in a manner oppressive to any of its members or that the company was formed for a fraudulent or unlawful purpose; (ii) the persons concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or misconduct; and (iii) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect.

Powers and duties of the Inspectors: The inspectors appointed by the Government must enquire into the affairs of the company concerned. The officers of the company and the directors, managing agents etc. must produce before them all books and documents required and must also give evidence on oath and answer questions put to them by the inspectors. If it is considered necessary, the inspectors may also examine the affairs of the holding company of the company concerned, any of its subsidiaries, its managing agents, secretaries and treasurers, and their associates and related companies. Under certain circumstances the inspector can seize documents after getting an order from a magistrate.

After the investigation is over, the inspectors must submit a report to the Government. They may also submit interim reports if considered necessary.

Government action on the report: After considering the report, the Government may take the following steps :

1. Copies of the report may be sent to all interested parties and published.

2. Officials of the company and directors, managing agents etc. who are found to be guilty of any offence, must be prosecuted.

3. If it is found that the company is entitled to proceed against any person for damages, recovery of property, or misfeasance, the Central Government can institute proceedings for the purpose.

4. If the investigation discloses the existence of circumstances which would lead the court to direct winding up of the company on the ground that it is just and equitable to do so, the Central Government can cause the presentation of a petition for winding up of the company or its managing agents, secretaries and treasurers or their associates.

5. The Central Government may cause an application to be filed before the court for exercise of the discretionary powers which have been given to the courts in cases of mismanagement and oppression. (Sections 397 and 398, see below.)

6. The expenses of the investigation may be recovered from the persons guilty of mismanagement or misconduct.

IV. Investigation of Ownership. (Sec. 217).

Where it appears to the Central Government that there is good reason so to do, it may appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company, for the purpose of determining the true persons—

(a) who are or have been financially interested in the success or failure, whether real or apparent, of the company, or

(b) who are or have been able to control or materially to influence the policy of the company.

V. Information about persons having interest in a company (Sec. 218).

Where it appears to the Central Government that there is good reason to investigate the ownership of any shares in or debentures of a company or of a body corporate acting as its managing agents or secretaries and treasurers, it may appoint inspectors for the purpose or may call for the information from the persons who are interested in the shares and debentures.

VI. Investigation of associateship (Sec. 249).

Where any question arises as to whether any person, firm or body corporate is or is not, or was or was not, an associate of the managing agent or the secretaries and treasurers, the Central Government may

appoint inspectors for the purpose or call for the relevant information from any person who is in a position to give information on the point.

Certain general provisions regarding enquiries and investigations: Where in connection with any of the investigations mentioned above, there is difficulty in finding out the relevant facts, the Central Government may declare that the shares of the company shall be subject to certain restrictions, e.g., any transfer of the shares to be void; where the shares are to be issued in the future, such issues are to be stopped; and the holders of the shares not to have any voting rights etc. If any person acts in violation of the above restrictions, he shall be punishable.—Sec. 250.

During investigations, questions may be asked from any person, but legal advisers cannot be forced to disclose privileged communications from their clients. There is protection for bankers as regards confidential information.—Sec. 251.

MISMANAGEMENT AND OPPRESSION BY THE MAJORITY

Companies are managed by directors elected by the majority. As regards matters which are to be decided by resolutions passed in general meeting, it is the opinion of the majority which always prevails. It has been laid down in many cases that the courts will not interfere in matters which are within the powers of the majority to decide. *Foss v. Harbottle*.¹ Thus the general rule for company management is that the decisions of the majority bind the minority.

Sometimes, however, it is found that a particular person or a group of persons has obtained control of the majority of the shares and is running the company in a manner prejudicial to the company or against the interests of the minority group of shareholders. Prior to 1951, the only remedy available to the oppressed minority in such cases was to apply for winding up of the company on the ground that it was just and equitable to do so. In 1951, the Companies Act of 1913 was amended by introducing certain sections which gave power to the courts to pass suitable orders for removing mismanagement and oppression, without directing winding up. The Act of 1956 provides that the Central Government can also take certain actions in such cases. Thus at present there are two remedies (in addition to winding up) which are available to the minority in cases of mismanagement and oppression by the majority. These remedies are described below.

¹ (1843) 2 Hare 461

I. Powers of the Court (Sections 397, 398).

On the petition of a member or members, of a company the Court can pass any orders that it considers necessary to provide relief against oppression and mismanagement, if it is shown :

(a) that the Company's affairs are being conducted in a manner oppressive to any member or members and that to wind up the Company would unfairly prejudice such member or members (even though grounds exist for a winding up order), or

(b) that the affairs of the Company are being conducted in a manner prejudicial to the interests of the Company, or

(c) that a material change (not being a change brought about by or in the interest of the creditors or any class of shareholders) has taken place in the management and control of the Company (by alterations in the Board of Directors, Managing Agents, Secretaries and Treasurers or Manager, or in the constitution and control of the firm or company acting as Managing Agent or Secretaries and Treasurers) and that by reason of such change, the affairs of the Company are likely to be conducted in a manner prejudicial to the interests of the Company.

The petitioning member must hold not less than one-tenth of the issued share capital of the Company on which all calls due have been paid, or must have obtained the consent in writing of one hundred or one-tenth in number of the members, whichever is less. In the case of a Company not having a share capital, the member petitioning must have obtained the consent in writing of not less than one-fifth in number of the members.

There is no restriction or limitation on the nature of the orders which the court may pass under Sections 397 and 398 in cases of oppression and mismanagement. Section 402 gives some examples of the type of order which the Court may pass *viz.*, orders for regulating the future conduct of affairs of the Company; orders directing the purchase of the shares of any members by other members or by the Company; reduction of capital; the termination of any agreement between the Company and its Manager, Managing Agent, Managing Director or any of its other Directors; orders for the termination or revision of any agreement between the Company and any other person; and orders for setting aside any transaction which would in the case of an individual be deemed in his insolvency to be a fraudulent preference.

If any such order makes an alteration of or addition to the Company's memorandum or articles, then (subject to the provisions

of the order) the Company concerned shall not make any further alteration or addition which is inconsistent with the order, without the leave of court.

A certified copy of any such order altering or adding to, or giving leave to alter or add to, the memorandum or articles, must be filed with the Registrar within fifteen days and default in compliance with this requirement renders the Company and every Officer in default liable to a fine which may extend to five thousand rupees.

Any termination or revision of any agreement made by the order of court shall not give rise to any claim for damages or for compensation. Further, no Managing Agent, or other Director or any associate of such Managing Agent shall, without the leave of the court, be appointed or re-appointed or be entitled to act for and under the Company for a period of five years from the date of the order. Any contravention of this provision is punishable with imprisonment for a term which may extend to one year or with fine up to Rs. 5,000/- or with both.

II. Powers of the Central Government (Sections 408, 409).

1. If an application is made by not less than 100 members of a Company or members holding not less than 1/10th of the voting power, complaining of oppression and mismanagement and the Central Government is satisfied that the allegations are true, it can by order do either of the following:

(a) appoint not more than two persons to hold office as Directors of the Company for a specified period, not exceeding three years; or

(b) direct the Company to amend the articles so as to provide for the election of Directors by proportional representation, and pending such amendment, appoint not more than two additional directors to the Board.

A person appointed director under the aforesaid provision need not hold any qualification shares, nor is he liable to retire by rotation. But he may be replaced by another person by the Central Government any time. So long as such a person holds office, no change in the Board of Directors has any effect unless confirmed by the Central Government.

2. If any Director, the Managing Agent, the Secretaries and Treasurers or Manager complains to the Central Government that as a result of a change in the ownership of the shares of the Company, the Board of Directors of the Company is likely to change in a manner prejudicial to the Company and the Central Government is satisfied

that the allegation is true, it can direct that no change in the Board shall have effect until confirmed by the Central Government.

THE ADVISORY COMMISSION

The Companies Act, 1956, provides for the appointment by the Central Government of an Advisory Commission consisting of a Chairman and not more than four other members. The function of the Commission is to give advice to the Government regarding Company matters and to conduct enquiries into matters referred to it by the Government.—Sections 410-415.

INFORMATION AND STATISTICS

The Central Government may, by order, require companies to furnish information and statistics regarding their constitution and working.—Sec. 615.

ANNUAL REPORTS BY GOVERNMENT

The Central Government is required to prepare an annual report regarding company law administration and submit it before the Parliament.—Section 638.

EXERCISE

1. What powers are given to the court and the Central Government by the Companies Act, 1956, for the prevention of oppression and mismanagement? (C.A. Nov. '56)

CHAPTER 12

GOVERNMENT COMPANIES

Definition. A Government Company is one in which not less than 51% of the paid up share capital is held by the Central Government and/or any State Government or Governments or by any two or more of them together.—Sec. 617.

Rules regarding Government Companies. The provisions of the Act of 1956 apply to Government Companies, subject to the exceptions and qualifications noted below.

1. A Government Company, formed after the commencement of the Act of 1956, cannot have a Managing Agent. But where a company becomes a Government Company after 1st April, 1956, it may continue with a managing agent appointed before the commencement of the amending Act of 1960.—Sec. 618.

2. Auditors of Government Companies are to be appointed by the Central Government on the advice of the Comptroller and Auditor General of India.—Sec. 619 (2).

3. The Comptroller and Auditor General can direct the manner in which the Company's accounts shall be audited. He can conduct a supplementary test audit of the Company's accounts by officers appointed by him. The auditor must submit a copy of the audit report to him and his comments thereon are to be placed before the annual general meeting of the Company.—Sec. 619 (3) to (5).

4. Where the Central Government is a member of a Government company, an annual report on its working and affairs (together with the audit reports and comments thereon) must be submitted to the Parliament. Where any State Government is a member of a Government Company, the annual report on the working and affairs of the Company, the audit reports and the comments thereon must also be placed before the state legislature or legislatures.—Sec. 619A.

5. The Central Government may by notification, direct that any of the provisions of the Companies Act (except the provisions noted under 1 to 4 above) shall not apply to any Government Company or apply with such exceptions, modifications and adaptations as may be specified in the notification. A copy of every notification, proposed

to be issued, must be laid in draft before both houses of Parliament for a period of not less than thirty days while they are in session. If within that period either house disapproves of the issue of the notification, it shall not be issued. If either house approves the issue of the notification subject only to modifications, it shall be issued only with such modifications as may be agreed upon by both the houses.—
Sec. 620.

CHAPTER 13

FOREIGN COMPANIES

Definition. Companies falling under the following two classes are called foreign companies (Sec. 591) :

(a) Companies incorporated outside India which, after the commencement of the Act of 1956, establish a place of business within India.

(b) Companies incorporated outside India which have, before the commencement of the Act of 1956, established a place of business within India and continue to have the same at the commencement of the Act.

Rules regarding Foreign Companies. The Companies Act contains the following provisions regarding Foreign Companies.

1. **Documents.** A foreign company shall within one month of the establishment of a place of business in India, deliver to the Registrar for registration: a certified copy of its memo, articles, charter and/or statutes by which it is incorporated; particulars regarding its Directors and Secretary; addresses of its registered office and principal place of business; and name and address of person or persons resident in India authorised to accept service of notices and processes on behalf of the company.—Sec. 592.

Alterations in any of the documents or particulars mentioned above must be immediately notified to the Registrar.—Sec. 593.

2. **Accounts.** A foreign company must prepare a balance sheet and profit and loss account in the same manner as companies under the Act of 1956 and submit three copies of the same to the Registrar. The Central Government may modify or cancel the application of this rule for any company.—Sec. 594.

3. **Name.** The name of a foreign company together with the name of the country where it is incorporated, must be conspicuously exhibited (on the outside of every office or place where it carries on business in India) in English and in one of the local languages.—Sec. 595 (b).

Its name and the name of the country where it is incorporated must also be stated in English in all business letters, bill heads and

letter paper and in all notices and other official publications of the company.—Sec. 595 (c).

If the liability of the members of the company is limited, the fact must be stated, in English and one of the local languages, on the outside of every office or place where it carries on business in India, and on its letter paper, bill heads etc.—Sec. 595 (d).

4. Registers etc. Provisions of the Act relating to registration of charges, appointment of receivers and the keeping of registers, documents and books of accounts, apply to foreign companies.—Sec. 600.

5. Prospectus. A prospectus inviting subscriptions for shares or debentures issued by a foreign company must state the following particulars: name of the Company in English, name of the country in which it is incorporated; whether the liability of the members is limited; particulars regarding its constitution, date of incorporation, addresses of its registered office and principal place of business; and matters required to be included in a prospectus issued by an Indian Company. Before it is issued, the prospectus must be registered with the Registrar. If there are untrue statements in the prospectus, the persons responsible for its issue are liable to the same extent and in the same manner as in the case of Indian Companies.—Sections 595 (a), 603-8.

6. Penalties. If the rules mentioned above are not complied with, the company and every officer or agent of the company who is in default may be punished.—Sec. 598.

7. Winding up. Where a body corporate incorporated outside India, which has been carrying on business in India, ceases to carry on business in India it may be wound up as an unregistered company according to the provisions of Part X of the Act. (See *post*.) A foreign company's business in India can be wound up even in cases where it has been dissolved or ceases to exist by virtue of the laws of the country where it was incorporated.—Sec. 584.

CHAPTER 14

WINDING UP

(The winding up or liquidation of a Company means the termination of the legal existence of a Company by stopping its business, collecting its assets and distributing the assets among creditors and shareholders, in the manner laid down in the Act.

MODES OF WINDING UP

There are three methods of winding up a Company ;

- I. Compulsory Winding Up by the Court.
- II. Voluntary Winding Up by the members themselves.
- III. Voluntary Winding Up under the supervision of the Court.

COMPULSORY WINDING UP

Compulsory Winding Up takes place when a Company is directed to be wound up by an order of Court.

Grounds of Compulsory Winding Up. (Sec. 433). A company may be wound up by the court under the following circumstances :

(a) If the Company has, by special resolution, resolved that the Company be wound up by Court.

(b) If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting.

In this case the Court may instead of ordering winding up, direct the holding of the meeting and filing of the report and order the party responsible for the default to pay the costs of the proceedings before the court.

(c) If the Company does not commence its business within a year from its incorporation, or suspends its business for a whole year.

The Court will not direct winding up under this clause if satisfactory reasons are given for the delay or suspension.

(d) If the number of members is reduced, in the case of a public Company to below seven, and in the case of a private Company to below two.

(e) If the Company is unable to pay its debts. [See below for the circumstances under which a company is deemed unable to pay its debts.]

(f) If the Court is of opinion that it is just and equitable that the Company should be wound up.

This clause gives a wide discretion to the Court and empowers the Court to order winding up in cases not coming within the previous five clauses. The following examples will show how the "just and equitable" clause has been used.

Examples :

- (i) Winding up may be ordered where a Company is carrying on its business at a loss and where it is totally impossible to make any profits.
- (ii) Where the "substratum of the Company" is gone, a winding up order will be issued. The substratum of a Company means its subject-matter or the objects for which it was incorporated. *Re : Janbazar Manna Estate.*¹
- (iii) A Company may be wound up where there is a deadlock in the management. In the case of *Yemdje Tobacco Company*² there were two Directors who were not on speaking terms and so no business could be conducted and winding up was ordered.
- (iv) A Company may be wound up under this clause if the objects of the Company are fraudulent.

The Court may refuse to order winding up under this clause if it is of opinion that some other remedy is available to the petitioners and they are acting unreasonably in asking for winding up, instead of pursuing the other remedies.

Company when deemed unable to pay its debts. (Sec. 434). A company is deemed to be unable to pay its debts under the following circumstances :

(i) If a creditor, entitled to receive a sum not less than Rs. 500, demands the money in writing and the company does not pay the money or settle the claim within three weeks of the date of demand. The notice of demand may be signed by the creditor or by his duly authorised agent or legal adviser.

If there are valid grounds for disputing the creditor's claim no order for winding up will be passed.

(ii) If execution or other process (issued on a decree or order of any court in favour of a creditor of the company) is returned unsatisfied in whole or in part.

(iii) If the court, after taking into account the contingent and

¹ 58 Cal 716

² (1916) 2 Ch. 426

the prospective liabilities of the company, is of opinion that the company is unable to pay its debts.

Who can apply for Winding Up? (Sec. 439). Subject to the qualifications mentioned below, an application for the winding up of a company can be made to the court by: (i) the Company (ii) any creditor or creditors, including any contingent or prospective creditor or creditors (iii) any contributory (which means a person liable to contribute to the assets of the company in the event of winding up) (iv) any of the aforesaid parties together (v) the Registrar (vi) a person authorised by the Central Government in cases where the Central Government can ask for the winding up of a company.

Contributory: A contributory can apply for winding up only under grounds (b) and (d) of Section 433. (Sec above.) In the latter case he must have been a registered shareholder for at least 6 months during the immediately preceding 18 months.

Registrar: The Registrar is entitled to apply for winding up under grounds (b) to (f) of Section 433. He must obtain the previous sanction of the Central Government. If he applies under ground (e), he must be satisfied on perusal of the balance sheet or the report of an inspector or special auditor that the company is unable to pay its debts.

Government: The Central Government can apply for winding up under ground (f), if such action is considered necessary after an enquiry into the affairs of a company by inspectors. (See Ch. 11).

Creditors: Creditors usually apply for winding up on the ground that the company is unable to pay its debts. The court will not order winding up if the claim is doubtful or if the company can show good grounds for non-payment. When a creditor applies for winding up, leave of the court is necessary. Leave will not be granted unless a *prima facie* case is made out and unless security for costs is given.

Commencement of Winding Up. The winding up of a Company by the Court is deemed to commence from the time of the presentation of the petition for winding up. Where, there was a resolution for voluntary winding up, before the presentation of the petition to Court, the winding up is deemed to commence from the date of the resolution. But the Court may direct otherwise in cases of fraud and mistake.—Sec. 441.

Powers of the Court. After a winding up petition is filed, notice is issued on the Company to appear and state its case if any. After hearing both sides, the Court may dismiss the petition, adjourn the

hearing conditionally or unconditionally, make any interim order necessary or pass an order for winding up.—Sec. 443.

If the order for winding up is passed, the Court appoints a "Liquidator" whose function is to take charge of and complete the winding up proceedings. The Liquidator carries out his duties according to the provisions of the Act and subject to the discretion and control of the Court.

To facilitate winding up proceedings, the Companies Act gives the following powers to the Court :

1. The winding up proceedings may be stayed either altogether or for a limited period if considered necessary.—Sec. 466.

2. The Court is to settle the list of contributories *i.e.* shareholders liable to pay money to the Company, determine how much is payable by each and direct the payment of the amount so determined.—Sections 467, 469.

The Court adjusts the rights of contributories among themselves and distributes any surplus among persons entitled thereto.—Sec. 475.

3. The Court may direct delivery to the Liquidator of any money, property or books and papers in the custody or control of any Contributory, Trustee, Receiver, Banker, Agent, Officer or Employee of the Company, to which the Company is *prima facie* entitled.—Sec. 468.

4. If any calls are due, the Court may direct the payment of the same.—Sec. 470.

5. The Court may fix a time within which creditors are to prove their claims, and may exclude creditors, not proving within the time, from the benefit of any distribution made before those debts and claims are proved.—Sec. 474.

6. In case of deficiency of assets, the Court may give priority to the payment of costs and charges of the winding up proceedings.—Sec. 476.

7. The Court may summon, for questioning, persons suspected of having in their possession property, books and papers of the Company, persons indebted to the Company, and persons capable of giving information regarding the formation of the Company and its dealings and transactions. The Court may direct return of property or payment of the moneys due to the liquidator. If any person summoned fails to appear, he may be arrested and brought before the Court.—Sec. 477.

8. If the Liquidator reports that any person concerned with the

formation of the Company or any officer of the Company, is guilty of fraud, the Court may direct his public examination. He can thereupon be publicly questioned in Court by the Court, Creditors, Contributories and the Official Liquidator.—Sec. 478.

9. If it is found that a contributory is about to quit India or to abscond or to remove and conceal any property for the purpose of avoiding payment or avoiding examination, he may be arrested and the relevant books, papers and movable property may be seized.—Sec. 479.

10. The Court may convene meetings of creditors and contributories with a view to ascertain their wishes.—Sec. 557.

11. The Court may, on proper grounds being shown, declare the dissolution of a Company and all proceedings connected therewith to be void.—Sec. 559.

OFFICIAL LIQUIDATORS

The Companies Act provides that in each High Court there shall be an Officer known as the Official Liquidator appointed by the Central Government. There may also be Deputy or Assistant Official Liquidators. In High Courts where there is insufficient work, there may be part-time Official Liquidators. In District Courts the Official Receiver or such other person as the Central Government will decide shall be the Official Liquidator.—Sec. 448.

Upon the presentation of a petition for winding up, the Court may appoint the Official Liquidator as the provisional liquidator. When the winding up order is passed, the Official Liquidator becomes the Liquidator of the Company.—Sec. 449.

After the winding up order is made, the Liquidator shall take into his custody and control all the properties, effects and actionable claims to which the Company appears to be entitled.

Duties of the Liquidator. The function of the Liquidator is to collect the assets of the Company, make a list of the creditors and pay the claims of the creditors *pro rata*. If the assets are sufficient to pay all the creditors, the balance left is to be distributed among the shareholders according to their rights. In all these matters he is subject to the control of the Court and must obtain directions from the Court whenever necessary.

The Liquidator is designated as "Official Liquidator of Company."

The Liquidator must pay all moneys received by him into the public account of India in the Reserve Bank of India.

The Liquidator must submit the prescribed returns and reports to the Court.

The Liquidator must keep the prescribed books of account and they shall be audited at least twice a year.

The Central Government is to keep watch over the conduct of the Liquidator and is to take suitable action if he does not carry out his duties faithfully. The Central Government may direct a local investigation of the books and vouchers of liquidators.

Statement of Affairs. After the liquidator has been appointed, a statement of the affairs of the Company is to be made to him in the prescribed form, verified by an affidavit, and containing particulars regarding the assets, debts and liabilities, names and addresses of the creditors etc. The statement shall be verified by a Director and the Manager, Secretary or other Chief Officer of the Company.—Sec. 451.

The Statement of Affairs enables the liquidator to know the position of the Company. The Court may dispense with the submission of the Statement of Affairs.

Report by Official Liquidator. As soon as practicable after the receipt of the Statement of Affairs and within 6 months after the date of the winding up order (or within such extended time as the Court may allow) the Official Liquidator shall submit to the Court a preliminary report. The report shall contain a statement of the amount of capital issued, subscribed and paid up, the estimated amount of assets and liabilities, causes of failure of the Company, and whether in the liquidator's opinion, fraud and punishable offences have been committed by directors and others, and further enquiry is necessary. The Liquidator may submit other reports later on whenever necessary, particularly as regards evidence of fraudulent practices.—Sec. 155.

Powers of the Liquidator. (Sec. 457).

(1) The liquidator in a winding up by the Court has power to do the following things *with the sanction of the Court*,—

- (a) to institute or defend any suit, prosecution, or other legal proceeding, civil or criminal, in the name and on behalf of the Company;
- (b) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;

- (c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer the whole thereof to any person or body corporate or to sell to the same in parcels;
- (d) to raise on the security of the assets of the company any money requisite,
- (e) to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets.

(2) The liquidator in a winding up by the Court has power to do the following things, *without taking special permission from the Court*—

- (a) to do all acts and to execute, in the name and on behalf of the company, all deeds, receipts, and other documents, and for that purpose to use, when necessary, the company's seal;
- (b) to inspect the records and returns of the company on the files of the Registrar without payment of any fee;
- (c) to prove, rank and claim in the insolvency of any contributory, for any balance against his estate, and to receive dividends in the insolvency;
- (d) to draw, accept, make and indorse any bill of exchange, hundi or promissory note in the name and on behalf of the company;
- (e) to take out, in his official name, letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company;
- (f) to appoint an agent to do any business which the liquidator is unable to do himself.

The Court can limit or modify the exercise of any of the powers of the liquidator enumerated in para. (2).

With the sanction of the Court, the Liquidator can pay any class of creditors in full; make any compromise or arrangement with creditors; and compromise any call or liability.—Sec. 516.

No Receiver can be appointed over assets in the hands of the Liquidator except by or with the leave of the Court.—Sec. 453.

Disclaimer of Onerous Property by Liquidator. (Sec. 535):

Where any part of the property of a company, which is being wound up, consists of (a) land burdened with onerous covenants (b)

shares or stock in companies (c) any property which is unsaleable or not readily saleable, or (d) unprofitable contracts, the Liquidator may, with the leave of the court, give up such property. This is known as Disclaimer of Onerous Property.

The Liquidator may disclaim a property even though he may have taken possession of the property or done something in relation to it. The disclaimer must be made in writing signed by the Liquidator.

The disclaimer must be made within twelve months after the commencement of the winding up or such extended time as may be allowed by the court. But where such property did not come to the knowledge of the Liquidator within one month of the commencement of the winding up, he may exercise his right of disclaimer at any time within twelve months after he has become aware thereof or such extended period as may be allowed by the court.

Any person, interested in a property or a contract may apply to the Liquidator in writing, requiring him to decide whether he will or will not disclaim. If the Liquidator does not (within twenty-eight days of the receipt of the letter or such extended time as the court may allow) give notice to the applicant that he intends to apply to the court for leave to disclaim, he shall be deemed to have adopted it.

Before granting leave to disclaim the court may require notices to be given to persons interested. The court may also impose conditions on the disclaimer.

Upon disclaimer, the rights, interest and liabilities of the company in that property come to an end. The court may direct delivery of the property to any person entitled thereto.

Any person injured by the operation of a disclaimer shall be deemed to be a creditor of the company to the amount of the compensation or damages payable in respect of the injury. He may prove the amount as a debt in the winding up.

COMMITTEE OF INSPECTION

The Committee of Inspection is a Joint Committee of creditors and contributories, consisting of not more than 12 persons. The function of the Committee is to keep a general watch over the acts of the liquidator for the protection of the interests of the creditors and contributories. For this purpose the Committee has the right to inspect the accounts of the liquidator at all reasonable times.

The court may, at the time of making the winding up order, or at any time thereafter, direct that there shall be appointed a Committee of Inspection. Within two months from the date of such direction, the liquidator shall convene a meeting of the creditors for the purpose of determining who are to be members of the committee. He shall also call a meeting of the contributories, within 14 days after the creditors' meeting (or such further time as may be allowed by the court). The contributories are to consider the decision of the creditors as regards the membership of the committee. If the two groups agree, the committee shall be formed accordingly. Otherwise the Court shall decide how the Committee is to be constituted.

The Committee of Inspection may meet as often as it desires. The liquidators or any member of the Committee can call a meeting. One third of the number of members, or two, whichever is higher constitutes the quorum. A member may resign. He loses membership if he becomes an insolvent or compounds with his creditors or absents himself from five consecutive meetings. A member may be removed by resolution of the group (creditors or contributories) from whom he has been selected as member. (Sections 464-465).

CONTRIBUTORIES

The term "Contributory" means every person liable to contribute to the assets of a Company in the event of its being wound up. When a limited liability Company is wound up only those shareholders who have not paid in full the amount due on their shares are liable to contribute. But the Companies Act includes, within the term contributory, the holders of fully paid up shares.—Sec. 428.

The reason is that in winding up proceedings it is necessary to prepare a complete list of all the members of a company so that the Court can determine, not only who shall contribute to the assets but also, who will get the surplus assets, if any.

The list of contributories is made up of two parts, A and B. The A list contains the names of persons who are members of the company on the date of the winding up. The B list contains the names of persons who were members within a period of one year previous to the date of winding up.

The Court settles the list of contributories. The rights and liabilities of different contributories are determined by the Court according to the rules laid down in the Act. Section 426 provides as follows:

(a) a past member shall not be liable to contribute if he has ceased to be a member for one year or upwards before the commencement of the winding up;

(b) a past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member ;

(c) no past member shall be liable to contribute unless it appears to the Court that the present members are unable to satisfy the contributions required to be made by them in pursuance of this Act ;

(d) in the case of a company limited by shares, no contribution shall be required from any past or present member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member ; and

(e) in the case of a company limited by guarantee, no contribution is required from any past or present member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up.

The liability of a contributory creates a debt payable by him at the time specified in calls made on him.—Sec. 429.

Upon the death of a contributory, his legal representative becomes a contributory.—Sec. 430. In case of insolvency, his assignees in insolvency represent him and the amount of contribution can be proved as a debt in the insolvency proceedings.—Sec. 431.

If the contributory is a company which is being wound up, its liquidator represents it and the amount of contribution due can be proved as a debt in the liquidation proceedings of the contributory company.—Sec. 432.

Obligations of directors, managing agents and managers whose liability is unlimited : (Sec. 427). In the winding up of a limited company, any director, managing agent, secretaries and treasurers or manager whether past or present whose liability is unlimited, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were, at the commencement of the winding up, a member of an unlimited company. But—

(a) a past director, managing agent, secretaries and treasurers or manager shall not be liable to make such further contribution if he has ceased to hold office for a year or upwards before the commencement of the winding up ;

(b) a past director, managing agent, secretaries and treasurers or manager shall not be liable to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office ;

(c) subject to the articles of the company, a director, managing

agent, secretaries and treasurers or manager shall not be liable to make such further contribution unless, the Court deems it necessary to require the contribution in order to satisfy the debts and liabilities of the company, and the costs, charges and expenses of the winding up.

VOLUNTARY WINDING UP

Voluntary winding up means winding up by the members themselves without the intervention of the court.

Section 484 of the Act provides that a company can be wound up voluntarily under the following circumstances :

1. By an *Ordinary Resolution* of the members passed in a general meeting in the following cases—

- (a) where the duration of the company was fixed by the articles and the period has expired; and
- (b) where the articles provided for winding up on the occurrence of any event and the specified event has occurred.

2. By a *Special Resolution* passed by the members in all other cases.

When a resolution is passed for voluntary winding up, it must be notified to the public by an advertisement in the Official Gazette and in a local newspaper.—Sec. 485.

A voluntary winding up is deemed to commence at the time when the resolution for the winding up is passed.—Sec. 486.

TYPES OF VOLUNTARY WINDING UP

There are two types of voluntary winding up. If the company is, at the time of winding up, a solvent company, *i.e.* able to pay its debts and the directors make a declaration to that effect, it is called a **Members' Voluntary Winding Up**. If the company is not in a position to pay its debts and the directors make no declaration of solvency, it is called a **Creditors' Voluntary Winding Up**.

The Declaration of Solvency. (Sec. 488). The Declaration of Solvency is to be made by all the directors (when there are only two directors) or by the majority of the directors (when there are more than two directors). The declaration must be to the effect that they have made a full enquiry into the affairs of the company and that they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within a specified period (not exceeding three years). The declaration must be verified by an affidavit and must be made at a meeting of the Board.

The declaration must be made within the five weeks immediately preceding the date of the passing of the resolution for winding up and must be delivered to the Registrar for registration before that date. The declaration must be accompanied by a copy of the auditors' report on the profits and loss account, the balance sheet and a statement of the assets and liabilities of the company as at the latest practicable date before the making of the declaration.

Any director making a declaration of solvency without reasonable grounds, may be punished with imprisonment up to six months and/or fine up to Rs. 5,000. If the company is wound up in pursuance of a resolution passed within the period of five weeks after the making of the declaration but its debts are not paid or provided for in full within the specified period, it shall be presumed until the contrary is shown, that the director did not have reasonable grounds for his opinion.

DIFFERENCES BETWEEN MEMBERS' VOLUNTARY AND CREDITORS' VOLUNTARY WINDING UP

1. The former applies to solvent companies and a declaration of solvency is necessary. The latter applies to insolvent companies and no declaration of solvency can be made.

2. In the former it is not necessary to have a creditors' meeting. In the latter there must be a creditors' meeting immediately following the members' meeting.

3. In the former, the liquidator is appointed by the members. In the latter both the members and the creditors may appoint a liquidator but if they nominate different persons, the creditors' nominee becomes the liquidator.

4. In the former, there is no Committee of Inspection. In the latter there may be one.

Provisions applicable to a Members' Voluntary Winding Up.

1. The company in general meeting appoints one or more liquidators and fixes their remuneration. Vacancies in the office of liquidators are filled by the company in general meeting.

2. On the appointment of liquidators, the powers of the Board of directors, managing or whole time directors, managing agents, secretaries and treasurers and managers, come to an end.

3. Notice of the appointment of the liquidator is to be given to the Registrar.

4. The liquidator must call a general meeting of the company at the end of every year and lay before it an account of his acts and dealings. If the liquidator finds that the company is actually insolvent he must immediately call a meeting of the creditors of the company.

5. As soon as the affairs of the company are fully wound up, the liquidator shall call a meeting of the company (by advertisement) and lay before it accounts showing how the winding up has been conducted. This meeting is called the Final Meeting of the Company. Within one week after the final meeting, the liquidator shall send to the Registrar a return of the holding of the final meeting and a copy of the final accounts. The Registrar shall forthwith register them. On the expiry of three months from the date of registration, the company shall be deemed to be dissolved.

Provisions applicable to a Creditors' Voluntary Winding Up.

1. The company shall call a meeting of the creditors to be held on the day or the day following the date on which the company will hold a general meeting of the members to pass the resolution for winding up. The notice of the creditors' meeting must be sent by post (simultaneously with the notice of the members' meeting) and must also be advertised in the Official Gazette and at least two local newspapers.

2. The Board of directors shall cause a full statement of the affairs of the Company and a list of creditors to be prepared and laid before the creditors' meeting. A Director is to be nominated to preside over the creditors' meeting. Copies of all resolutions passed in the creditors' meeting are to be sent to the Registrar.

3. The members and the creditors, in their respective meetings, can nominate a liquidator. In case the two groups nominate different persons as liquidator, the creditor's nominee shall be the liquidator. But the Court may, on an application made to it, appoint some other person (including the Official Liquidator) as the liquidator.

4. The creditors may, in a meeting, appoint a Committee of Inspection consisting of not more than five persons. The members of the Company may thereafter appoint not more than five members to the Committee from among themselves. If the creditors object to the persons nominated by the members, some other persons must be appointed, unless the Court, on an application made to it, decides otherwise. The functions of the Committee are the same as those of a Committee of Inspection appointed in a Compulsory Winding Up. (See *ante*.)

5. The remuneration of the liquidator is to be fixed by the Committee of Inspection or if there is no such Committee, by the creditors. If they fix no remuneration, the Court is to do it.

6. On the appointment of a liquidator, the powers of the Board of directors come to an end except in so far as the Committee of Inspection or, if there is no such Committee, the creditors in a general meeting may sanction the continuation thereof.

7. In the event of the winding up continuing for more than one year, the liquidator shall call at the end of each year a meeting of members and a meeting of the creditors. The liquidator shall place before the meetings an account of his acts and dealings and of the conduct of the winding up during the preceding year.

8. When the affairs of the Company, are fully wound up the liquidator shall call a final meeting of the members and creditors and place before them, the final accounts.

Within one week after the holding of the above meetings, the liquidator shall send a return of the meetings and a copy of the final accounts to the Registrar who shall forthwith register them. On the expiration of three months from the date of registration, the Company shall be deemed to be dissolved. But the Court may, on an application made to it by the liquidator or any other person interested, postpone the date of dissolution.

Provisions applicable to both types of Voluntary Winding Up.

1. A body corporate cannot be appointed as liquidator. The use of corrupt inducements for the appointment of a person as liquidator is a punishable offence. When a liquidator has been appointed he shall within 21 days, inform the Registrar and advertise the same in the Official Gazette. If no liquidator is acting the Court can appoint the official Liquidator or any other person as liquidator. The Court can remove a liquidator on cause shown.

2. The liquidator or any contributory or creditor can apply to the Court for direction on any matter arising out of the winding up proceedings.

3. The liquidator may apply to the Court for an order directing the public examination of any promoter, director or officer of the Company where there is reason to believe that fraud has been committed.

4. An arrangement entered into between the company and its creditors is binding if it is sanctioned by a special resolution of the company and agreed to by three-fourths of the number of creditors and by persons entitled to three fourths of the claims.

5. The costs of winding up, including the remuneration of the liquidator, are payable out of the assets of the company in priority to all other claims.

6. **Powers of the Liquidator.** The liquidator in a voluntary winding up has all the powers which a liquidator in a compulsory winding up has. The powers which the latter can exercise with the sanction of the Court, the former can exercise with the sanction of a special resolution of the Company in the case of a members' voluntary winding up and in the case of a creditors' voluntary winding up, with the sanction of the Court, of the Committee of inspection, or (where there is no such Committee) of the creditors in a general meeting.

In addition to the aforesaid, the liquidator in a voluntary winding up has the following powers :

- (a) to settle the list of contributories and adjust the rights of contributories among themselves ;
- (b) to make calls upon contributories ;
- (c) to call general meetings of the company ; and
- (d) to enter into schemes of arrangement or compromise with creditors with the sanction of a special resolution of the company (or the Court or the Committee of inspection) and accept shares and properties of another company as part of such schemes.

WINDING UP SUBJECT TO THE SUPERVISION OF COURT

At any time after a company has passed a resolution for voluntary winding up, the Court may make an order that the voluntary winding up shall continue but subject to the supervision of the Court.—Sec. 522.

A supervision order is usually made for the protection of the creditors and contributories of the company. In *Re Prince of Wales State Quarry Co.*,³ it was held that such an order may be passed if (a) the Liquidator under voluntary liquidation is partial or is negligent in collecting the assets (b) the rules relating to winding up are not being observed, or (c) the resolution for winding up was obtained by fraud.

A supervision order has the following effects :

1. It gives jurisdiction to the court over suits and legal proceedings against the company to the same extent as in a winding up directly by the court.—Sec. 523.

³ (1868) 18 L.T. 77

2. The court can appoint an additional liquidator or liquidators. The court can remove any liquidator and fill any vacancy caused by removal, death or resignation. The Official Liquidator may be appointed liquidator in such cases.—Sec. 524.

3. **Powers of the Liquidator.** The liquidator in a winding up under the supervision of the Court can exercise all the powers of a liquidator in a voluntary winding up. But the Court can modify or limit his powers and can also give him additional powers.—Sections 525, 526 (1).

4. After a supervision order is passed the court can exercise all powers which it might have exercised if an order had been made for winding up by the court.—Sec. 526 (2). The powers of the court include the power to make calls and to stay suits and proceedings.

COMPULSORY WINDING UP PENDING VOLUNTARY WINDING UP

Where a company is being wound up voluntarily or subject to the supervision of the court a petition for its compulsory winding up may be presented by any person entitled to apply for winding up or the Official Liquidator. Upon the making of such a petition, the Court may pass an order for compulsory winding up, if it is of opinion that such a course of action is necessary in the interest of the creditors or contributories.—Sec. 440.

CONSEQUENCES OF WINDING UP

When the Court passes an order for the compulsory winding up of a company, intimation of it must be sent immediately to the Official Liquidator. A copy of the order must also be sent to the Registrar of Companies by the petitioners who filed the winding up application. In a voluntary winding up as soon as the liquidator is appointed he must inform the Registrar.

The consequences which follow from winding up proceedings can be classified under three heads (a) those which follow all types of winding up; (b) the additional consequences in a compulsory winding up; and (c) the same in a voluntary winding up.

I. Consequences which follow all types of Winding Up.

1. The Board of Directors of the Company ceases to have any powers (except in certain special cases in a voluntary winding up).

2. The property and effects of the company come under the custody of the liquidator who has to realise the assets and distribute them according to the rules laid down in the Act.—Sec. 456.

3. Every invoice, order for goods or business letters issued on behalf of the company by the liquidator and others and in which the name of the company appears, shall contain a statement that the company is in liquidation.—Sec. 547.

4. **Fraudulent Preference.** All transactions of the company, made within six months previous to the commencement of the winding up, which amount to fraudulent preferences, are invalid.—Sec. 531.

Fraudulent preference means any transfer of money or property to a creditor which has the effect of giving him an undue preference as compared with other creditors.

5. **Avoidance of Voluntary Transfer.** The term 'voluntary transfer' in this context means any transfer of property or delivery of goods by a company, not in the ordinary course of business and not in favour of a purchaser or encumbrancer in good faith and for valuable consideration. All such transfers, made *within a period of one year* before the presentation of a petition for winding up (by or under the supervision of the Court) or the passing of a resolution for voluntary winding up, are void as against the liquidator.—Sec. 531 A.

6. Any transfer or assignment by a company of all its properties to trustees for the benefit of all its creditors, becomes void upon an winding up order being passed.—Sec. 532.

7. A floating charge created within 12 months previous to the commencement of winding up is invalid except to the extent of the cash actually paid to the company plus interest at 5 per cent or such other rate as may be notified by the Government. This rule will not apply if it can be shown that the company was in a solvent position immediately after the creation of the charge.—Sec. 534.

8. Persons guilty of offences antecedent to or in course of winding up are liable to prosecution and punishment. The Companies Act species what these offences are. *Some examples:* failure to give information or statement to the liquidator regarding assets of the company; falsification of books; failure to keep proper accounts; frauds committed in course of formation or working of the Company.—Sec. 538.

9. If in the course of the winding up of a company it appears that any person who has taken part in the promotion or formation of the company or any past or present director, managing agent, secretaries and treasurers, manager, liquidator or officer of the company,

(a) has misapplied, or retained, or become liable or accountable for any money or property of the company; or

(b) has been guilty of any misfeasance or breach of trust in relation to the company;

the Court may, on the application of the liquidator, or of any creditor or contributory, examine the conduct of such person and compel him to repay or restore the money or property or make him pay compensation for the misapplication, retainer, misfeasance, or breach of trust.—Sec. 543 (1).

An application under the above rule shall be made within five years from the date of the order for winding up or the date of the first appointment of the liquidator or of the misapplication, misfeasance etc., whichever is longer.—Sec. 543 (2).

Action under Section 543 may be taken notwithstanding that the matter is one for which the person is criminally liable.—Sec. 543 (3).

II. Additional consequences which follow Compulsory Winding Up.

1. When a winding up order is passed the court has to send intimation thereof forthwith to the Official Liquidator and the Registrar.—Sec. 444.

2. A certified copy of the winding up order must be sent to the Registrar by the petitioner and the Company within one month of the date of the order. Failure to do so is a punishable offence.—Sec. 445.

3. The winding up order operates as notice of discharge to the officers and employees of the company, except where the business of the company is continued according to the provisions of the Act.—Sec. 445 (3).

4. After the winding up order is passed or the official liquidator is appointed as the provisional liquidator, no suit or proceeding can be commenced against the company, and pending suits and matters cannot be proceeded with, except by the leave of the winding up court and subject to such terms as the court may impose. The court which has passed the winding up order can entertain and dispose of suits and claims by or against the company and questions of priorities in winding up. It can also transfer to itself suits and proceedings pending in other courts except those pending in appeal before the Supreme Court or a High Court.—Sec. 446.

5. In the case of a winding up by the court or under supervision of the court, the following transactions are void; any disposition

of property or actionable claims or transfer of shares or alteration in the status of a member made after the winding up order, unless the court otherwise declares; and, any attachment, distress or execution and sale of the company's properties without the leave of the court.—Sections 536 (2), 537.

III. Additional consequences in a Voluntary Winding Up.

1. The company shall, from the commencement of the winding up, cease to carry on its business, except so far as may be required for the beneficial winding up of such business.—Sec. 487.

2. Any transfer of shares and alteration in the status of any member made without the leave of the liquidator, is void.—Sec. 536 (1).

MODE OF DISTRIBUTION OF ASSETS

All debts payable by the company and claims, whether certain or contingent and whether present or future, can be proved in the winding up proceedings and payment claimed from the liquidator. Sec. 528.

Regarding debts provable, valuation of annuities and future and contingent liabilities and the respective rights of secured and unsecured creditors, the rules applicable in winding up proceedings are the rules which are applied in insolvency proceedings under the insolvency Acts.—Sec. 529.

Preferential Payments. (Sec. 530). The costs of the winding up proceedings are to be paid first out of the assets. Next in order of priority comes the following debts:

1. Revenues, taxes, cesses and rates due to the Central or a State Government.

2. Wages and salary of any employee for a period not exceeding 4 months within the twelve months before the commencement of the winding up or the appointment of the provisional liquidator, and compensation payable under the Industrial Disputes Act. For any one claimant, priority shall not be given for any sum exceeding Rs. 1,000, except where the claimant is an agricultural labourer.

3. All accrued holiday remuneration to an employee becoming payable on account of the termination of service by the winding up order.

4. The company's contribution to the employee's provident fund during twelve months previous to the winding up, unless the winding up is for the purpose of reconstruction or amalgamation.

5. Payments due to a workman under the Workmen's Compensation Act.

6. All sums due to an employee from a provident fund, pension fund, gratuity fund or any other fund maintained for the welfare of the employees.

7. Expenses of enquiries and investigations payable by companies.

The debts mentioned above rank equally among themselves and must be paid in full if there are sufficient assets. They have priority over the claims of debenture-holders under any floating charge, and over the claims of landlords and others in goods distrained by them within three months next before the winding up order. But if the assets are insufficient, the preferential payments shall abate proportionately.

Books and Papers of the Company. (Sec. 550). When the affairs of the company have been completely wound up, its books and papers shall be disposed of in the following way :

(a) in a members' voluntary winding up—as the company by special resolution directs ;

(b) in a creditors' voluntary winding up—as the Committee of Inspection or, in its absence, as the creditors direct , and

(c) in all other cases—as the court directs.

After the expiry of 5 years from the date of dissolution, no responsibility shall rest on the liquidator or any other person to produce the books, unless the Central Government otherwise directs.

Unclaimed Dividends and Undistributed Assets. (Sec. 555). If any money payable to a creditor or contributory remains unclaimed or undistributed for six months after the date on which it became payable, the Liquidator shall deposit it into the public account of the Government of India in the Reserve Bank of India. The same thing is to be done with other moneys lying in the hands of the Liquidator at the date of the dissolution of the company.

In the case of a voluntary winding up, with or without a supervision order, the Liquidator shall pay undistributed assets into the Company's Liquidation Account of the Reserve Bank of India.

Any person claiming any money lying in the above account may apply to the court or the Central Government for an order directing payment to him.

Moneys which remain unpaid in the Company's Liquidation Account for a period of 15 years shall be transferred to the General

Revenue Accounts of the Central Government. But orders may be passed for payment to any person who can prove his claim for any sum originally lying in the Company's Liquidation Account.

DEFUNCT COMPANIES

A defunct company means a company which is not carrying on business or is not in operation. Section 560 provides as follows :

When the Registrar has reasonable cause to believe that a company is a defunct company, he shall send a letter to the company asking whether it is so. If no reply is received within one month, the Registrar shall within another fourteen days, send a registered letter referring to the first letter. If no answer is received to the second letter within one month a notice is to be published in the Official Gazette and a letter is to be sent to the company informing it that its name shall be struck off the Register within three months, unless cause is shown to the contrary. If no such cause is shown within three months, the Registrar shall strike off the name of the company from the Register.

A similar procedure is to be followed when in the case of a company in liquidation, the Registrar believes that there is no liquidator or that the liquidator is not acting.

The court may restore the name of the company to the Register if sufficient cause is shown.

WINDING UP OF UNREGISTERED COMPANIES

An unregistered company means a partnership, association or company consisting of more than 7 members and not coming within any of the following categories : (Sec. 582) .

(a) a Railway company incorporated by an Act of Parliament in India or U.K. ;

(b) a company registered under the Companies Act of 1956 ; or

(c) a company registered under any previous Companies Act with its registered office in India.

An unregistered company can be wound up under the Companies Act. The procedure applicable is, with certain minor exceptions, the same as in the case of a compulsory winding up. Such companies cannot be wound up voluntarily or under the supervision of the court. If a foreign company carrying on business in India, ceases to do so, it can be wound up according to the procedure applicable to unregistered companies.

EXERCISES

1. What is winding up? State briefly the different modes of winding up of a company. (C.U. '56)
2. What are the modes of winding up? Discuss the circumstances in which a company may be wound up by court. (C.U. '59; C.A. May '59; May '61)
3. What are the main effects of a winding up order by the court? (C.U. '54)
4. Under what circumstances will a court order winding up of a company? What are the consequences of such order? (C.U. '61)
5. Under what circumstances can a company be voluntarily wound up? Distinguish between a Members' Voluntary Winding Up and a Creditors' Voluntary Winding Up. (C.U. '50, '53; C.A., May '53)
6. What do you understand by the term "Contributory"? What is the nature of the liability as contributories of present and past members? (C.U. '52)
7. (a) Define the term contributory and indicate the nature of the liability of the contributory.
(b) When is a contributory entitled to petition for the winding up of a company? (C.A. Nov. '59)
8. (a) When may a contributory petition for the winding up of a company?
(b) What is a Committee of Inspection?
(c) What is a Public Examination in a winding up? (C.A. Nov. '60)
9. What is a Committee of Inspection in a compulsory winding up? What are the functions of such a committee? (C.U. '52)
10. Who is an Official Liquidator? What are his powers? (C.U. '48, '52)
11. State when the Liquidator may disclaim any property in the winding up of a company. Is the leave of the court necessary in any case? (C.U. '53)
12. Write notes on: Contributories (C.U. '60); Official Liquidator; Supervision Order; Committee of Inspection; Preferential Payments; Defunct Companies; Unregistered Companies

BOOK VI
THE LAW RELATING TO NEGOTIABLE INSTRUMENTS

CHAPTER 1

DEFINITIONS

NEGOTIABLE INSTRUMENTS

Documents of a certain type, used in commercial transactions and monetary dealings, are called Negotiable Instruments.

"Negotiable" means transferable by delivery and "instrument" means a written document by which a right is created in favour of some person. The term negotiable instrument, therefore, literally means "a document transferable by delivery". In English mercantile law, the term is used in this wide sense. Thus Judge Wallis says that a negotiable instrument is one in which, "the true owner could transfer the contract or engagement contained therein by simple delivery of the instrument".¹

In India the term negotiable instrument is used in a restricted sense. The law relating to such instruments is contained in the Negotiable Instruments Act of 1881 which states that, "A Negotiable Instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer".—Sec. 13(1). Thus in India only three kinds of instruments are recognised as negotiable instruments *viz.* promissory notes, bills of exchange and cheques.

Bills of lading, dividend warrants, *Hundis* and similar other documents are not covered by the Negotiable Instruments Act. But as these documents are, in various respects, analogous to notes and bills, the rules laid down in the Act relating to negotiable instruments are, under certain circumstances, applied to them.

The Negotiable Instruments Act is based on English law. It is more or less a codification of the English common law rules on the subject.

THE PROMISSORY NOTE

Definition. "A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional

¹ Wallis on Negotiable Instruments.

undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument."—Sec. 4.

The person who makes the promise to pay is called the **Maker**. He is the debtor and must sign the instrument. The person who will get the money (the creditor) is called the **Payee**.

Essential Elements. From the definition given in the Act it is apparent that the following essential requirements must be fulfilled by an instrument intended to be a promissory note :

1. The instrument must be in writing.
2. The instrument must contain a promise to pay. The promise to pay must be express. It cannot be implied or inferred. A mere acknowledgement of indebtedness is not enough.

Example :

"Mr. Sen I.O.U. Rs. 1000." Here I.O.U. stands for, "I owe you." This is only an admission of indebtedness. There is no promise to pay and therefore the instrument is not a promissory note.

3. The promise to pay must be unconditional. If the promise to pay is coupled with a condition it is not a promissory note.

Example :

(i) "I promise to pay B Rs. 300, first deducting thereout any money which he may owe me."

(ii) "I promise to pay B Rs. 500 on D's death, provided D leaves me enough to pay this sum."

(iii) "I promise to pay B Rs. 500, seven days after D's marriage."

These instruments are not promissory notes because the promise to pay is coupled with a condition. "I promise to pay B Rs 500 on demand" is a note with an unconditional promise.

Stipulations of the following type are *not* regarded as conditions : promise to pay at a specified time or at a specified place or after the occurrence of an event which is certain to occur, or payment after calculating interest at a certain rate.

Examples :

"I promise to pay B Rs. 500 on 1st April, 1960." "I promise to pay B Rs. 500 on demand at Bombay." "I promise to pay B Rs. 500 seven days after the death of C." These are all valid promissory notes.

4. The maker of the instrument must be certain and definite.

5. The instrument must be signed by the maker of it. A signature in pencil or by a rubber stamp or facsimile is good. An illiterate person may use a mark or cross instead of writing out his name. The signature or mark may be placed anywhere on the instrument, not necessarily at the bottom. It may be at the top or at the back of the instrument.

6. The sum of money to be paid must be certain.

Examples :

- (i) "I promise to pay B Rs. 500 and all other sums which shall be due to him."
- (ii) "I promise to pay B some money on the occasion of his marriage."

The above instruments are not promissory notes because the sum of money to be paid is uncertain.

7. The money must be payable to a definite person or according to his order. (A promissory note cannot be made payable to the *bearer on demand*. See below.) A note is valid even if the payee is misnamed or is indicated by his official designation only. Evidence is admissible to show who the payee really is.

8. The payment must be in the legal tender money of India. A promise to pay a certain quantity of goods or a certain amount of foreign money is not a promissory note.

Specimens of Promissory notes. An instrument is valid as a promissory note if it is so drafted as to satisfy the essential requirements of a promissory note. Subject to this condition the parties may use any form desired. Some typical forms are given below.

Examples :

- (i) "On demand I promise to pay A.B. of No. 13, Mirzapur Street or order Rs. 1000 (Rupees one thousand only) with interest at 8 per cent per annum, for value received in cash."
Address_____
- X.Y.
Date_____
- (ii) One year after date I promise to pay C.D or order Rs. 1000."
Sd/X.Y.
Date_____
- (iii) "On demand I promise to pay B or order Rs 500"—Sd/X Y.
- (iv) "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for value received"—Sd/X.Y.

BILL OF EXCHANGE

Definition. "A Bill of Exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument."—Sec. 5.

The maker of a bill of exchange is called the **Drawer**. The person who is directed to pay is called the **Drawee**. The person who will receive the money is called the **Payee**. When the payee has custody of the bill, he is called the **Holder**. It is the holder's duty to present the bill to the drawee for his acceptance. The drawee signifies his acceptance by signing on the bill. After such signature the drawee becomes the **Acceptor**.

In a bill of exchange sometimes the name of another person is mentioned as the person who will accept the bill if the original drawee does not accept it. Such a person is called the **Drawee in case of Need**.

Essential Elements of a Bill of Exchange. A Bill of Exchange to be valid must fulfil the following requirements:

1. The instrument must be in writing.
2. The instrument must contain an order to pay, which is express and unconditional.
3. The drawer, drawee and the payee must be certain and definite individuals.
4. The instrument must be signed by the drawer.
5. The amount of money to be paid must be certain.
6. The payment must be in the legal tender money of India.
7. The money must be payable to a definite person or according to his order. A bill of exchange cannot be made payable to the bearer on demand.—(See below.)

The requirements are more or less the same as in promissory notes and are subject to similar conditions as regards signature etc.

If any of the requirements mentioned above is not fulfilled, the document is not a bill of exchange.

Examples:

- (i) "Please let the bearer have seven pounds and oblige." This is not a bill of exchange because it is a request and not an order. *Little v. Slackford*.²
- (ii) "We hereby authorise you to pay on our account to the order of X, £600" This is not a bill of exchange because it is not an order to pay. *Hamilton v Spottiswoode*.³

Specimens of Bills of Exchange. A bill of exchange may be drawn in any form, provided the requirements mentioned above are fulfilled.

Examples

- (1)

To A.B.
 Six months after date pay P.Q. or order Rs. 1000.

Sd/X.Y.
Date_____

Stamp—
- (ii)

One month after sight pay to P.Q. or bearer (or order)
 Rs. 500.

Sd/X.Y.
Date_____

Stamp—

Differences between a promissory note and a bill of exchange.

1. In a promissory note there are two parties—the maker and the payee. In a bill of exchange there are three parties—the drawer, the drawee, and the payee.

² (1828) M & W 171

¹ (1849) 4 Ex. 200

2. In a promissory note there is a *promise* to pay. In a bill of exchange there is an *order* to pay.

3. A promissory note is signed by the person liable to pay; therefore, no acceptance is necessary. A bill of exchange, except in certain cases, requires to be accepted by the drawee before it is binding upon him.

4. The maker of a promissory note is primarily liable on the instrument. The drawer of a bill is liable only when the drawee does not accept the instrument or pay the money due.

5. In case of non-payment or non-acceptance of a bill notice must be given to all persons liable to pay. This is called the notice of dishonour. In the case of a promissory note, notice of dishonour to the maker is not necessary.

Banker's Drafts. A Bill of Exchange is sometimes called a Draft. A Bill of Exchange drawn by a bank on its branch or on any other bank is called a Banker's Draft. A banker's draft cannot be made payable to bearer.

NOTES AND BILLS PAYABLE TO THE BEARER ON DEMAND

It is provided by Section 31 of the Reserve Bank of India Act that a promissory note or a bill of exchange *payable to the bearer on demand* can be issued only by the Reserve Bank of India or by the Central Government. The reason is that a bill or note payable to the bearer on demand may circulate from hand to hand and be used as money. Private persons are not allowed to create such documents. If a note or bill is, by error, made payable to bearer on demand it will be treated by law as payable to order.

JOINT NOTES AND BILLS

A promissory note or a bill of exchange may be signed by two or more persons jointly. In such cases their liabilities are joint and several.

A negotiable instrument may be payable to two or more persons jointly. But it cannot be made payable *to* or *by* two persons alternatively. A promissory note signed by *X or Y* is valid as against *X* but not as against *Y*.

UNDATED BILLS AND NOTES

A negotiable instrument without a date is not necessarily invalid. If the legal requirements for the validity of an instrument are fulfilled,

the instrument is valid and the date of execution can be proved by oral or other evidence. The holder in due course can insert the *true* date on the instrument and such insertion is not considered to be a material alteration.

INTEREST ON BILLS AND NOTES

When a promissory note or a bill of exchange specifically mentions the rate at which interest is payable, interest must be paid at that rate from the date of the instrument to the date of realisation of the money. If a suit is filed on the instrument, interest is payable up to such date as the court may decide.—Sec. 79.

When no rate of interest is specified in the instrument, interest is payable (notwithstanding any agreement between the parties regarding interest) at 6% per annum from the date on which the money ought to have been paid till the date of realisation. When a suit is filed, the court is to decide the date up to which interest is payable.—Sec. 80.

When the party charged is the indorser of an instrument dishonoured by non-payment, he is liable to pay interest only from the time that he receives notice of the dishonour.—Sec. 80, Expl.

CHEQUES

Definition. A cheque is a bill of exchange drawn upon a specified banker and payable on demand.—Sec. 6.

A cheque may be payable to bearer or to order but in either case it must be payable on demand. The banker named must pay it when it is presented for payment to him at his office during the usual office hours, provided the cheque is validly drawn and the drawer has sufficient funds to his credit.

A cheque must fulfil all the essential requirements of a bill of exchange. Bills and notes may be written entirely by hand. There is no legal bar to cheques being hand-written. Usually however, banks provide their customers with printed cheque forms which are filled up and signed by the drawer. The signature must tally with the specimen signature of the drawer kept in the bank. A cheque must be dated. A banker is entitled to refuse to pay a cheque which is not dated. A cheque becomes due for payment on the date specified on it. A cheque drawn with a future date is valid but it is payable on and after the date specified. Such cheques are called post-dated cheques. A cheque may be presented for payment after the due date but if there is too much delay the bank is entitled to consider

the circumstance suspicious and refuse to honour the cheque. The period after which a cheque is considered too old or "stale" varies according to custom from place to place. It is usually six months in Indian cities.

The usual form of a cheque. Cheques are usually printed in the form shown below.

Example :

To X. Y. Bank Ltd.

Date.....

Pay A. B. or order (or bearer) the sum of Rupees Five Hundred only.

Rs. 500/-

Sd/ C. D.

Different types of cheques. There are two types of cheques: Open Cheques and Crossed Cheques. An open cheque is one which is payable in cash across the counter of the bank. A crossed cheque is one which has two short parallel lines marked across its face.

A cheque marked in this fashion can be paid only to another banker. Naturally it will not be paid across the counter. The system of crossing cheques arose by mercantile usage and was later on sanctioned by law. The advantage of crossing is that it reduces the danger of unauthorised persons getting possession of a cheque and cashing it. A crossed cheque can only be cashed through a bank of which the payee of the cheque is a customer.

There are different modes of crossing a cheque. The simplest mode of crossing is to put two parallel lines across the face of the cheque. This is called General Crossing. A cheque crossed generally will be paid to *any* bank through which it is presented. When the name of a bank is written between the parallel lines, it is called Special Crossing. A cheque crossed specially will be paid only when it is presented for collection by the bank named between the parallel lines. Such crossing affords a greater measure of protection against loss.

In addition to general or special crossing, a cheque may contain various remarks written on it, the effect of which is to restrict payment in certain ways. The usual remarks are "Account Payee" and "Not Negotiable."

"Account Payee". The words 'account payee' on a cheque is interpreted as a direction on the banker to credit the proceeds of the cheque to the account of the payee. The negotiation of such cheques is not prohibited. *National Bank v. Silke*.⁴

~ **"Not Negotiable".** A cheque marked with the words "not negotiable" can be transferred or assigned by the payee. The transferee will get the same rights, as regards payment, as the transferor had.

⁴ (1891) 1 Q.B. 435

But the transferee will not get the rights of a holder in due course. (See below.)

Certification of Cheques by Banks. In some countries there is a custom of making a cheque with the words "good for payment" by the drawee bank (*i.e.* in U.S.A.). Where there is such a custom, marking a cheque as good is equivalent to acceptance by the bank concerned and binds the bank to pay the cheque when presented for payment by the payee or any transferee from him. The effect of this practice is that, once a cheque is certified as good for payment, it cannot be countermanded by the drawer, and the payee is certain of getting the money. It has been held by the Privy Council in *Bank of Baroda v. Punjab National Bank*,⁵ that the practice of marking or certifying cheques has not been established in India, either by judicial decisions or by statutes. Therefore, even if a particular cheque is marked as good, the drawee bank in India may refuse to honour it if there are insufficient funds.

Crossing after issue. Section 125 of the Negotiable Instruments Act provides as follows:

Where a cheque is uncrossed, the holder may cross it generally or specially.

Where a cheque is crossed generally, the holder may cross it specially.

Where a cheque is crossed generally or specially, the holder may add the words, "not negotiable".

Where a cheque is crossed specially, the banker to whom it is crossed specially may again cross it specially to another banker, his agent, for collection.

Protection to bankers as regards payment of crossed cheques.—See under Ch. 7.

Distinction between Bill of Exchange and Cheque.

1. A bill of exchange can be drawn upon any person, including a bank. A cheque can be drawn only upon a bank. Thus every cheque is a bill of exchange but every bill of exchange is not a cheque.

2. Except under certain specified circumstances, a bill of exchange requires acceptance. A cheque does not require any acceptance.

3. A cheque is always payable on demand. The acceptor of a bill of exchange is allowed a grace period of three days, after the maturity of the bill, to make the payment.

⁵ (1944) A.C. 176

4. The drawer of a bill is discharged from liability if the bill is not presented to the acceptor for payment at the due time. But the drawer of a cheque is discharged from his liability only if he suffers damage owing to delay in presenting the cheque for payment.

Example :

The holder of a cheque retains it for two months after the due date without attempting to cash it. In the meantime the bank goes into liquidation. Had the cheque been presented for payment earlier it would have been paid. Owing to the undue delay in presentation the drawer has lost his money. He is therefore, not required to pay the holder again. What is undue delay is a question of fact depending on the circumstances of the case.

5. If a bank fails to pay a cheque, it is not necessary to give notice of dishonour to the drawer to make him liable to compensate the payee. In the case of bills of exchange, it is necessary to give notice of dishonour, except in certain special cases.

6. A cheque may be crossed; there is no provision for crossing a bill.

7. The payment of a cheque may be countermanded by the drawer. The payment of a bill cannot be countermanded.

8. A cheque does not require any stamp. A bill of exchange (except in certain cases) must be stamped.

BEARER INSTRUMENTS AND ORDER INSTRUMENTS

A negotiable instrument may be payable to bearer or to the order of a person. An instrument is *payable to bearer* (i) when it is expressed to be so payable *i.e.* when words like the following are used: "Pay bearer" or "Pay X or bearer", and (ii) when the last indorsement on the instrument is an indorsement in blank *i.e.* when there is an order to pay but the name of the payee is not mentioned.

When an instrument is payable to bearer, any person lawfully in possession of it as holder is entitled to receive the payment due on it. It is not necessary that his name should be written on the instrument. But after the bearer of the instrument is paid, he may be required to acknowledge receipt of the money by signing on the instrument.

A negotiable instrument is *payable to order* in the following cases :

(i) When it is expressed to be payable to order, *e.g.* "Pay to X or order". An instrument payable "to the order of P" is payable to P or according to his order.

(ii) When it is payable to a particular person and the instrument does not contain words prohibiting or restricting transfer. *Example :* "Pay to Q". The money is payable to Q or according to his order.

To negotiate an instrument payable to order, the signature of the holder is necessary.

THE TIME OF PAYMENT OF A NEGOTIABLE INSTRUMENT

A promissory note or a bill of exchange may be payable on demand or on a specified date or after a specified period of time. The time of payment is usually mentioned in the instrument. If no time of payment is mentioned, the instrument is payable on demand. A cheque is always payable on demand.

In a promissory note or a bill of exchange, the expressions "at sight" or "on presentment" means on demand. The expression "after sight" means in a promissory note, after presentment for sight. In a bill of exchange it means, after acceptance or noting for non-acceptance or protest for non-acceptance.—Sec. 21.

A promissory note or a bill of exchange may be made payable by instalments.

Maturity of a Note or Bill. The maturity of a bill or note is the date on which it falls due. A bill or note which is payable *on demand* becomes due immediately on presentation for payment. A bill or note which is *not payable on demand* becomes mature on the third day after the day on which it is expressed to be payable. The three days are known as the *Days of Grace*. The date of maturity of a bill or note is calculated in the following way: (Sections 23 to 25).

(a) If it is payable a stated number of months after date or after sight, it becomes payable three days after the corresponding date of the month after the stated number of months.

(b) If the month in which the stated number of months will terminate has no corresponding date, it becomes mature on the last day of the month.

(c) In calculating the maturity of a bill or note payable a certain number of days after date or sight, the day on which it was drawn or presented for acceptance shall be excluded.

(d) When the day on which a bill or note is at maturity is a holiday, the instrument shall be deemed to be due on the next preceding business day.

The expression "Public Holiday" includes Sundays, New Year's Day, Christmas Day: if either of such days falls on Sunday, the next following Monday; Good Friday; and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.

The following illustrations are given in the Act as regards the mode of calculating maturity of bills and notes.

Examples :

- (i) A negotiable instrument, dated 30th August 1878, is made payable three months after date. The instrument is at maturity on 3rd December 1878.
- (ii) A negotiable instrument, dated 29th January 1878, is made payable at one month after date. The instrument is at maturity on the 3rd day after the 28th February 1878.
- (iii) A negotiable instrument dated 31st August 1878, is made payable three months after date. The instrument is at maturity on the 3rd December 1878.

FEATURES COMMON TO ALL NEGOTIABLE INSTRUMENTS

1. Negotiable instruments can be transferred from one person to another by a simple process. In the case of bearer instruments, delivery to the transferee is sufficient. In the case of order instruments, two things are required for a valid transfer : indorsement (*i.e.* signature of the holder) and delivery. An instrument may be made non-transferable by using suitable words *e.g.* "Pay to X only".

2. The transferee of a negotiable instrument, when he fulfils certain conditions, is called the holder in due course (*see post*). The holder in due course gets a good title to the instrument even in cases where the title of the transferor is defective.

3. It is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay. The transferee can sue in his own name.

4. Certain presumptions apply to all negotiable instruments. *Example :* it is presumed that there is consideration. It is not necessary to write in a promissory note the words "for value received" or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

5. A special procedure is provided for suits on promissory notes and bills of exchange. A decree can be obtained much more quickly than it can be in ordinary suits.

6. A document which fails to qualify as a negotiable instrument may nevertheless be used as evidence of the fact of indebtedness.

Example :

P writes to Q "I.O.U. Rs. 500". This is not a promissory note but the document can be used as evidence to show that P is indebted to Q for Rs. 500.

Negotiable instruments are popular in commercial transactions because of their easy negotiability and quick remedies.

AMBIGUOUS INSTRUMENTS

An instrument which owing to faulty drafting, can be interpreted either as a promissory note or as a bill of exchange, is called an Ambiguous Instrument.

Example :

A signs an instrument which purports to be an order upon B to pay a certain sum of money to the order of A and negotiates the instrument to C. B is a non-existent person. The instrument is drafted like a bill but it can be interpreted as a promissory note by A because B being a non-existent person, A is liable to pay to the holder the money due on it.

An ambiguous instrument can be treated either as a bill or as a note, at the option of the holder.—Sec. 17. The holder must decide once for all, whether to treat the instrument as a bill or as a note. After he decides one way he cannot change his mind.

If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.—Sec. 18.

Example .

A promissory note is written as follows, "On demand I promise to pay B Rs. 200 (Rupees one hundred only)." The note is valid for Rs. 100 only.

INCHOATE STAMPED INSTRUMENT

An inchoate stamped instrument is a paper signed and stamped in accordance with the law relating to negotiable instruments and either wholly blank or containing an incomplete negotiable instrument. When one person gives to another such a document, the latter is *prima facie* entitled to complete the document and make it into a proper negotiable instrument up to the value mentioned in the instrument, if any, or up to the value covered by the stamp affixed on it. The person signing the instrument is liable on it, in the capacity in which he signed it, to any holder in due course for such amount. But persons who are not holders in due course cannot recover more than the amount intended to be paid by the signatory.—Sec. 20.

Example :

X signs a promissory note without stating the amount payable, puts stamp on it sufficient to cover Rs. 500 and hands it to his clerk Y for making certain purchases, instructing Y to put in the value of the purchases as the amount payable. Y purchases goods worth Rs. 400 but puts in Rs. 500 in the promissory note. The note is negotiated to Z, who takes it for consideration without any notice of the real transaction. Z can recover Rs. 500 from X. But the shopkeeper, is presumably aware of all the circumstances and if he had retained the instrument he would have been entitled to recover only Rs. 400.

HOLDER

The holder of a negotiable instrument means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.—Sec. 8.

Only the person legally entitled to receive the money due on the instrument, is called the Holder. Thus clerks or servants having the instrument in their custody are not holders except as agents of the holder. A person who obtains possession of the instrument by illegal means (*e.g.* theft) is not a holder.

HOLDER IN DUE COURSE

The holder in due course is a particular kind of holder. The holder of a negotiable instrument is called the holder in due course if he satisfies the following conditions. (Sec. 9) :

1. He obtained the instrument for valuable consideration.
2. He became holder of the instrument before its maturity, *i.e.* before the amount mentioned in it became payable.
3. He had no cause to believe that any defect existed in the title of the person from whom he derived his title.

From the aforesaid conditions it is clear that a person cannot be a holder in due course if,

- (a) he has obtained the instrument by gift or for an unlawful consideration or by illegal methods ;
- (b) if he has obtained the instrument after its maturity ; and
- (c) if the circumstances are such that a reasonable person would suspect that the title of the transferor is defective.

Examples of circumstances which should be considered suspicious :

- (i) An instrument torn to pieces and pasted together. *Baxendale v. Bennett*.⁶
- (ii) An instrument containing erasures.

A post dated cheque does not indicate any defective title and therefore the transferee of such a cheque may be a holder in due course if the other conditions are satisfied. *Hithcock v. Edwards*.⁷

Rights of a holder in due course. The holder in due course is in a privileged position. Under the law he has the following rights :

1. The holder in due course gets a good title to the instrument even though the title of the transferor is defective. If X obtains an instrument by fraud, he cannot sue on it. But if X transfers the instrument to Y under circumstances which make Y a holder in due course, Y can sue on the instrument and get the amount due on

⁶ (1878) 3 Q.B.D. 525.

⁷ (1889) 60 L.T. 636

it. The party liable to pay can take, as against *X*, the defence of fraud but as against *Y* he will not be allowed to take such a defence.

2. Negotiable instruments are sometimes handed over to agents for a particular purpose *e.g.* for collection. If the agent acts beyond his authority and transfers the instrument to a person who satisfies the conditions of a holder in due course, the latter can recover the amount mentioned in the instrument. The party liable to pay cannot plead that the agent acted without authority.

3. The holder in due course gets a good title even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker.

4. The holder in due course can file a suit, against the parties liable to pay, in his own name.

5. The acceptor of a bill of exchange drawn in a fictitious name and payable according to the drawer's order is liable to pay to the holder in due course, if there is an endorsement on the bill signed in the same hand as the drawer's signature and purporting to be made by the drawer. The acceptor cannot plead, by way of defence, that the bill is drawn in a fictitious name.—Sec. 42.

6. The maker of a promissory note, the drawer of a bill of exchange or cheque, and the acceptor of a bill of exchange for the honour of the drawer, in a suit thereon by the holder in due course, is not permitted to deny the validity of the instrument as originally made or drawn.—Sec. 120.

But section 120 does not prevent a minor from taking the defence of minority. Also, there is no liability if the signature is forged.

7. The indorser of a negotiable instrument, in a suit thereon by a subsequent holder, is not permitted to deny the signature or the capacity to contract of any prior party to the instrument.—Sec. 122.

Transferee from a holder in due course. A holder of a negotiable instrument who derives title from a holder in due course has the rights thereon of that holder in due course.—Sec. 53.

PAYMENT IN DUE COURSE

"Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned."—Sec. 10.

A negotiable instrument is "paid in due course" when the following conditions are satisfied ;

1. The payment is according to the apparent tenor of the instrument. [*Tenor* means the prescribed time of payment.]
2. The payment is in good faith and without negligence.
3. The payment is to the possessor of the instrument.
4. There does not exist any ground for believing that the possessor is not entitled to receive payment.

Payment in due course completely discharges the obligations of the party liable to pay, even though it subsequently transpires that payment has been made to the wrong person. (See Ch. 7, "Bankers and Customers.")

Usance. The time allowed for the payment of bills drawn in one country and payable in another (foreign bills) is called usance. The time varies according to the distance between the countries and is determined by customary rules.

INLAND INSTRUMENTS AND FOREIGN INSTRUMENTS

A negotiable instrument drawn or made in India, and made payable in, or drawn upon any person resident in India is called an Inland Instrument.—Sec. 11.

Inland instruments are those which are (i) made or drawn in India, and (ii) payable in India or payable by a person resident in India.

Foreign instruments are those which are (i) made or drawn in India but are payable by a person resident outside India, or (ii) which are made or drawn outside India but are payable in India.

The distinction between inland instruments and foreign instruments is important because an inland bill need not be protested for dishonour while a foreign bill may have to be protested for dishonour if the law of the place where it is drawn so requires.

ACCOMMODATION BILLS

An Accommodation Bill is one which has been signed by a person, as drawer, acceptor or indorser, without any consideration, with a view to oblige some other person, *i.e.* to provide him with funds.

Example :

Y desires to have Rs. 1000 and approaches X for that purpose. X has no funds in hand but has credit in the market. It is arranged that Y will draw a bill on X for Rs. 1000, payable after three months, and X will accept the bill. Y can negotiate the bill and get the money. Before the maturity of the bill, Y will provide X with funds sufficient to meet it. Thus X is able to get the required funds for three months. Such a bill is called an accommodation bill.

The party accommodating (X) is called the "Accommodation Party" and the party accommodated (Y) is called the "Accommodated Party". Sometimes a party may be accommodated by indorsing an existing bill without consideration. Such indorser is called the "Backer". Backing a bill gives it value because the endorser is liable to all subsequent parties.

The Negotiable Instruments Act lays down the following rules regarding accommodation bills :

1. The accommodation party is liable to pay the money due on the instrument to any holder for value. Thus in the above example if the bill was endorsed to P, P can on the maturity of the bill demand the money from X. P is entitled to receive the money even if he was aware that X is an accommodation party. X can, of course, recover from Y whatever he pays on the bill.—Sec. 43.

2. The accommodated party (Y, in the example given above) cannot demand the money from the accommodation party (X) if he holds the bill till maturity.

3. An accommodation bill can be negotiated after maturity.—Sec. 59.

4. Non-presentment of an accommodation bill to the acceptor for payment does not discharge the drawer.—Sec. 76.

5. In the case of an accommodation bill, failure to give notice of dishonour does not discharge the liability of the prior parties, as it does in the case of other bills.—Sec. 98.

FICTITIOUS BILLS

A bill is called a fictitious bill when the name of the drawer or the payee or both are fictitious.

A fictitious bill, payable to the order of the drawer, and accepted by a genuine person becomes a good bill in the hands of a holder in due course. The holder in due course is entitled to payment from the acceptor if he can show that the first endorsement on the bill and the signature of the supposed drawer are in the same handwriting. If the holder knew that the drawer's name is fictitious, he cannot claim the money because, in this case, he is not a holder in due course.—Sec. 42.

BILLS IN SETS

Sometimes a bill of exchange is drawn in several parts (two, three or four, as the circumstances may require). This is usually done in the case of foreign bills because they have to be sent over long distances and there exists a possibility of loss or delay.

Rules regarding Bills in Sets. (Sections 132 and 133).

1. Each part of a bill in set must be numbered and must contain a provision that it shall continue payable only so long as the others remain unpaid. All the parts together make a set and the whole set constitutes one bill. Each part requires to be stamped.
2. The entire bill is extinguished when one of the parts is extinguished (*e.g.* when payment is made on one part).
3. When a person accepts or endorses different parts of the bill to different persons, he and the subsequent indorsers of each part are liable on each such part as if it were a separate bill. Therefore the acceptor should only accept one part of the set.
4. As between holders in due course of different parts of the same set he who first acquired title to his part is entitled to the other parts and the money represented by the bill.

DOCUMENTARY BILLS

A documentary bill is one to which documents of title like bills of lading are annexed. When the bill is accepted or paid, the documents of title are handed over. This is the usual practice in foreign trade transactions.

ESCROW

A bill delivered conditionally is called Escrow. A bill may be endorsed or delivered to a person subject to the understanding that it will be payable only if certain conditions are fulfilled. *Examples*: a promissory note given as collateral security for raising capital for a partnership; an instrument left with a person for safe custody.

In the case of an escrow, there is no liability to pay unless the conditions agreed upon are fulfilled. But the rights of a holder in due course are not affected.

REASONABLE TIME

The following rules are laid down in the Act regarding the interpretation of the term "reasonable time" which is used at various places in the Act (Sections 105-107):

In determining what is a reasonable time for presentment of acceptance or payment, for giving notice of dishonour and for noting, regard shall be had to the nature of the instrument and the usual course of dealing with respect to similar instruments; and, in calculating such time, public holidays shall be excluded.

If the holder and the party to whom notice of dishonour is given carry on business or live (as the case may be) in different places, such notice is given within a reasonable time if it is despatched by the next post or on the day next after the day of dishonour.

If the said parties carry on business or live in the same place, such notice is given within a reasonable time if it is despatched in time to reach its destination on the day next after the day of dishonour.

A party receiving notice of dishonour, who seeks to enforce his right against a prior party, transmits the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder.

EXERCISES

1. What is a negotiable instrument ? (C.U. '50; '59)
2. Distinguish between :
 - (a) A promissory note and a bill of exchange (C.U. '46; '47; '50)
 - (b) A bill of exchange and a cheque (C.U. '49; '52)
 - (c) Cheques crossed generally & cheque crossed specially (C.U. '52)
 - (d) Holder and holder in due course. (C.U. '46; '47)
3. Define a promissory note and distinguish it from a bill of exchange and a cheque. (C.U. '57)
4. Distinguish between a Bill of Exchange and a Promissory Note. Who is a Drawee in case of need ? (C.U., B Com. '62)
5. Who is a holder in due course ? What are his rights ? (C.U. 49; '61)
6. What is the effect of crossing a cheque with the words "not negotiable" written across its face ? (C.U. '50; C.A., Nov. '51)
7. What are the requirements of a bill in sets ? (C.A., Nov. '50)
8. Write explanatory notes on : Negotiable Instrument; "Account Payee" indorsement; Certification of Cheques; Maturity of a Note or Bill; Bill of Exchange payable at Sight; Ambiguous Instrument; Inchoate Instrument; Payment in Due Course; Days of Grace; Tenor; Usance; Inland Instruments and Foreign Instruments; Accommodation Bills; Bills in Sets; Documentary Bills; Fictitious Bills; Escrow; Reasonable Time.
9. What is meant by marking or certification of cheques by a bank and what are the liabilities of the bank in regard thereto ? (C.A., Nov. '53)
10. What is a Bill of Exchange ? Describe its special characteristics. (C.A., Nov. '50)

CHAPTER 2

ACCEPTANCE AND NEGOTIATION

A bill of exchange is said to be accepted when the drawee puts his signature on it, thereby acknowledging his liability under the bill. There are certain special cases where a bill need not be accepted. Except in these cases, the drawee is not liable on a bill until and unless he accepts the bill.

The usual mode of acceptance is writing the word "accepted" across the bill and signing under it. Writing the word "accepted" is not essential but the signature is. The signature may be put anywhere, on the face of the bill or on the back of it.

ACCEPTANCE AND NEGOTIATION

Acceptance may be either (i) General or (ii) Qualified.

Acceptance is General when it is unconditional and unqualified, i.e. when the drawee accepts liability to pay the amount mentioned in the bill in full, without any condition or limitation. The acceptor may mention the bank where payment will be made. This does not amount to putting a condition.

Acceptance is said to be qualified when the acceptor puts some conditions on the acceptance. *Examples*: acceptance for an amount less than that mentioned in the bill; stipulating a place of payment other than that mentioned in the bill etc.

A qualified acceptance may be refused by the holder. He can in such a case treat the bill as dishonoured by non-acceptance and take legal steps to recover his dues from the parties liable. The holder may, if he chooses, accept qualified acceptance. The acceptor thereupon becomes liable only to the extent, and subject to the conditions, mentioned in the qualified acceptance. If a qualified acceptance is accepted, all persons who were parties to the bill prior to such acceptance, are discharged from their liabilities under the bill, excepting those if any, who consent to such acceptance.

The drawee is not required to accept a bill immediately on presentation. He is entitled to have 48 hours time to think over it.—Sec. 63. After the 48 hours are over he must return the bill to the holder, with or without acceptance as the case may be. If during his custody of the bill, it is mutilated, lost or destroyed, he must compensate the

holder. If the holder allows the drawee more than 48 hours for deliberation, all prior parties to the bill are discharged from their liabilities under the bill.

When acceptance is not necessary. Acceptance is not necessary in the case of bills of exchange payable on demand or at sight, unless in any such bill it is specially mentioned that it is to be accepted before payment. All other bills require acceptance.

The Presentment for Acceptance. (Sec. 61). A bill which requires to be accepted must be presented for acceptance before the drawee or his authorised agent.

If a bill is directed to the drawee at a particular place, it must be presented at that place. When authorised by agreement or usage, a presentment through the post office by a registered letter is sufficient.

The document must be presented for acceptance before the date of payment and within a reasonable time after it is drawn.

If the drawee after a reasonable search cannot be found, the bill can be treated as dishonoured.

If a bill, which requires acceptance, is *not* presented for acceptance in accordance with the rules mentioned above, the drawer and all indorsers are discharged from their liability to the holder.

When presentment for acceptance is not necessary. Presentment for acceptance is not necessary in the following cases

1. When after a reasonable search the drawee cannot be found—Sec. 61.

2. When the bill is drawn on a non-existing or fictitious person or on a person who is incapable of entering into contracts (*e.g.* a minor or a lunatic).—Sec. 91.

3. When the drawee is insolvent or dead.—Sec. 75.

Who can accept a bill? Only the following persons can accept a bill of exchange :

1. The drawee of the bill.

2. The drawee in case of need.

3. When there are several drawees, any one or more of them can accept the bill. If the several drawees are partners, any one of them can accept on behalf of all of them. But if they are not partners, each drawee can accept only on behalf of himself and not on behalf of anybody else, unless specially authorised.—Sec. 34.

4. A bill may be accepted by a person for the honour of the drawee. This is known as acceptance for honour. This is the only case where a bill may be accepted by a stranger to the instrument. (See Chapter 4).

Dishonour by non-acceptance. A bill of exchange is said to be dishonoured by non-acceptance when the drawee or one of several drawees not being partners, makes default in acceptance upon being duly required to accept the bill, or where presentment is excused and the bill is not accepted.

When the drawee is incompetent to contract, or the acceptance is qualified, the bill may be treated as dishonoured.—Sec. 91.

NEGOTIATION

Definition. Negotiation of an instrument is the process by which the ownership of the instrument is transferred from one person to another.

“When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated.”—Sec. 14.

A negotiable instrument payable to bearer can be negotiated by delivery, *i.e.* by merely handing over the instrument to the transferee or his agent.—Sec. 47. But the intention to transfer the ownership of the instrument must be present. If an instrument is handed over to another for safe custody or for a special purpose (*e.g.* to a solicitor for filing a suit) the delivery does not amount to negotiation.

A negotiable instrument payable to order can be negotiated by endorsement and delivery. Endorsement or Indorsement means signature of the holder made with the object of transferring the document.

Endorsement may be made on the face of the instrument or on its back. If there is no space on the instrument, the endorsement may be made on an attached slip of paper. Such a slip is known as *Allonge*.

Who can negotiate. The sole maker, drawer, payee or endorsee and if there are several makers, drawers, payees or endorsees, all of them jointly can negotiate an instrument, provided its negotiability has not been restricted or excluded by any term used in the instrument.—Sec. 51.

The maker or drawer cannot endorse or negotiate an instrument unless he is in lawful possession of the instrument or is the holder thereof. A payee or indorsee cannot endorse or negotiate unless he is the holder thereof.

The duration of negotiability. A negotiable instrument can be negotiated until payment or satisfaction. After payment or satisfaction it cannot be negotiated. An instrument can be negotiated at or after maturity, provided it has not been paid or satisfied.—Sec. 60.

Effect of Indorsement. The indorsement of a negotiable instrument followed by the delivery thereof, transfers to the indorsee the property therein with the right of further negotiation; but the right of further negotiation may be restricted or excluded by express words.—Sec. 50.

Negotiation and Assignment. Negotiation means transfer of a negotiable instrument in accordance with the procedure laid down in the Negotiable Instruments Act. Assignment means the transfer of a right or an actionable claim (chose-in-action) by deed or otherwise.

When a negotiable instrument is negotiated, the transferee, if he takes the instrument bonafide and for value, becomes a holder in due course. A holder in due course is not affected by any defect in the title of the transferor. He may therefore have a better title than the transferor. In the case of an assignment, the assignee gets the rights of the assignor and nothing more. If the title of the assignor was defective, the title of the assignee is also defective.

In the case of an assignment the assignee must give notice to the debtor. In the case of negotiation, no notice to the debtor is required to be given.

In the case of negotiation, consideration is presumed. In an assignment, there is no presumption of consideration and the party claiming has to prove consideration.

TYPES OF INDORSEMENT

There are two kinds of indorsement: (i) Indorsement in Full and (ii) Indorsement in Blank. When the indorser mentions the name of the person to whom the money due on an instrument is to be paid, it is said to be indorsed in full. *Example*: "Pay to X or order" Sd/Y. Where the name of the party is not mentioned it is said to be indorsed in blank. *Example*: "Pay ..." Sd/Y. Mere signature without any words amounts to an indorsement in blank, provided the indorsement was made with the intention of transferring the instrument. For an indorsement in full, no particular words are necessary. Any term indicating an intention to transfer the document to a particular person or to his order, accompanied by signature, is sufficient.

The holder of an instrument indorsed in blank is entitled to put in his own name or the name of any other person above the indorsement and thereby convert the indorsement in blank to an indorsement in full. In such a case the amount due on the instrument cannot be claimed from the indorser in full except by the person to whom it has

been indorsed in full or a person who derives title from such indorser in full.—Sec. 55.

If the payee's or the indorsee's name is wrongly spelt, he should (when he again indorses it) sign the name as spelt in the instrument, and write the correct spelling within brackets after his indorsement.

A negotiable instrument indorsed blank is payable to the bearer thereof even although it was originally payable to order.—Sec. 54. But this rule does not apply to crossed cheques.

INSTRUMENTS WHICH ARE NOT NEGOTIABLE

An instrument becomes non-negotiable when the indorsement on it contains express words which,

- (a) restrict or exclude the right of further negotiation ; or
- (b) merely constitute the indorsee an agent to indorse the instrument ; or
- (c) merely entitle the indorsee to receive the contents for the indorser or for some other specified person.—Sec. 50.

Examples :

An instrument becomes non-negotiable if it contains the following words in the indorsement :

- (i) "Pay the contents to C only."
- (ii) "Pay C for my use."
- (iii) "Pay C or order for the account of B."
- (iv) "The within must be credited to C."

The following indorsements do not exclude the right of further negotiation by C : (i) "Pay C." (ii) "Pay C, value in account with the Oriental Bank." (iii) "Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the indorser and others."

Cheques which are marked "not negotiable" or "account payee" are nevertheless transferable but the transferee does not become a holder in due course. (*See ante*).

INDORSEMENTS EXCLUDING PERSONAL LIABILITY

The indorser of a negotiable instrument may, by express words in the indorsement, exclude his own liability thereon. He can also make his liability or the right of the indorsee to receive the amount due thereon depend on the happening of a specified event, although such event may never happen.—Sec. 52.

As agent signing a negotiable instrument may exclude his personal liability by using words to indicate that he is signing as agent only. The same rule applies to directors of a company signing instruments on behalf of a company. The intention to exclude personal liability must be clear.

When an indorser excludes his liability and afterwards becomes the holder of the instrument, all intermediate indorsers are liable to him *i.e.* he regains the position he occupied before he made the restrictive indorsement.

Examples :

- (i) The indorser of a negotiable instrument signs his name adding the words, "without recourse" or "*sans recourse*". Upon this indorsement he incurs no liability.
- (ii) The indorsement on an instrument is "For and on behalf of X company. Sd/P, director." P has no personal liability.
- (iii) A is the payee and holder of a negotiable instrument. He transfers the instrument to B *sans recourse*. B transfers the instrument to C and C to A. A is not only reinstated in his former rights, but has the rights of an indorsee against B and C.

RESTRICTIVE INDORSEMENT

An indorsement is said to be restrictive when the indorser, by express words, restricts the right of further negotiation of the instrument or merely entitles the indorsee of the instrument to receive the contents of the instrument for a specific purpose.

Examples :

"Pay C for my use." "Pay C or order for the account of B."

FACULTATIVE INDORSEMENT

When the indorser, by express words, abandons some right or increases his liability under a negotiable instrument, the indorsement is called Facultative.

Example :

An indorsement with the remark "notice of dishonour not required".

PARTIAL INDORSEMENT

An indorsement which purports to transfer only a part of the amount due on a negotiable instrument, is invalid. But where an instrument has been partly paid, it can be negotiated for the balance, provided the fact of part-payment is noted on the instrument.—Sec. 56.

Examples :

- (i) The holder of a promissory note for Rs. 1000 writes on it, "Pay B Rs. 500/-" and indorses the note. The indorsement is invalid for the purpose of negotiation.
- (ii) The maker of a promissory note for Rs. 1000 pays Rs. 500, and the fact is noted on the instrument. The holder can negotiate the note for the balance due on it.

**"ONCE A BEARER INSTRUMENT, ALWAYS A
BEARER INSTRUMENT"**

If a negotiable instrument is endorsed in blank or is payable to bearer, it is a bearer instrument. The holder of such an instrument may negotiate it by delivery only. But suppose that the holder indorses it specially to a person and makes it payable to the order of such person. In such a case the indorser in full cannot be sued by any person except the person in whose favour he indorsed it, but as regards all parties prior to the indorser in full, the instrument remains transferable by delivery.—Sec. 55.

Example :

X, the payee of a bill, indorses it in blank and delivers it to Y. Y indorses it to Z or order. Z without any indorsement transfers it to P. P as the bearer is entitled to receive payment. In case of dishonour P is entitled to sue the drawer and the acceptor of the bill and also X, the indorser in blank and all indorsers prior to X. He cannot however sue Y or Z.

Where a cheque is originally expressed to be payable to bearer the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether in full or in blank appearing thereon, and notwithstanding that any such indorsement purports to restrict or exclude further negotiation.—Sec. 85 (2).

EXERCISES

1. In what sense are the following expressions used in the Negotiable Instruments Act?—Negotiation; Endorsement; Maturity of a Promissory Note or a Bill of Exchange. (C.U. '51)
2. Can a person who indorses and delivers a negotiable instrument before maturity, expressly exclude or make conditional his own liability? (C.U. '52)
3. Distinguish between negotiability and assignability in connection with negotiable instruments. (C.A., May '52)
4. It is said that "Once a bearer instrument always a bearer instrument". Discuss the correctness of this statement with special reference to the law in India. (C.A., May '51; Nov. '52)
5. Write notes on : Qualified Acceptance; Presentment for Acceptance; Allonge; Endorsement.
6. Explain what is meant by qualified acceptance. Is a holder bound to acquiesce in such and what is the effect of such qualified acceptance? (C.A., May '61)

CHAPTER 3

RIGHTS AND LIABILITIES OF THE PARTIES

WHO CAN BE PARTIES TO A NEGOTIABLE INSTRUMENT ?

The capacity to make, draw, accept, negotiate and indorse a negotiable instrument depends on the capacity to enter into contracts.

Every person capable of contracting may bind himself and be bound by a negotiable instrument. A person incapable of contracting cannot bind himself but may, under certain circumstances, bind others. When some of the parties to a negotiable instrument are capable of contracting and some are not, the capable parties are bound while the incapable parties are not. The provisions of law regarding the different cases of incapacity, as regards negotiable instruments, are summarised below.

Minor. A minor may draw, indorse, deliver and negotiate a negotiable instrument so as to bind all parties except himself.—Sec. 26.

Thus a minor party to a negotiable instrument is not personally liable but the adult parties are. When an instrument is signed by a minor and an adult jointly, the minor is not liable but the adult is. The defence of minority can be taken by the minor even though he might have concealed his age deliberately or made a false representation concerning it. If a minor is the payee under a negotiable instrument, he can enforce payment.

Lunatic, Idiot and Drunken Persons. The legal position is the same as in the case of minors. A lunatic can, however, bind himself by a negotiable instrument if he signs it during a lucid interval.

Insolvent. After the order of adjudication is passed, the properties of the insolvent vest in the Official Assignee or the Official Receiver. The insolvent therefore cannot draw, make, accept or indorse a negotiable instrument. A bill drawn upon the insolvent before he became insolvent may be presented to the Official Assignee for acceptance. An instrument executed after insolvency in favour of the insolvent, vests in the Official Assignee or the Official Receiver.

Corporation. A corporation can incur liabilities under a negotiable instrument if it is so empowered by its memo and articles. A trading company has implied powers to borrow and can do so by executing negotiable instruments. A non-trading company has no im-

plied powers to borrow and can execute negotiable instruments only if specifically empowered to do so.

Agent. Every person capable of binding himself or be bound by a negotiable instrument may so bind himself or be bound by a duly authorised agent acting in his name.—Sec. 27.

The agent must indicate that he is signing as agent, by using specific words to that effect ; otherwise he will be personally responsible. The personal responsibility cannot be enforced by persons who induced the agent to sign upon the belief that only the principal would be liable. Except in such cases, the agent is personally responsible if the fact of agency is not clearly indicated.—Sec. 28.

The authority to execute negotiable instruments must be given specifically. A general authority to act as agent does not include the authority to execute negotiable instruments. An authority to draw bills of exchange does not of itself import an authority to indorse.—Sec. 27.

The fact of agency may be indicated by using the following words : “for and on behalf of” or “*per pro*” which is short for “*per procuracionem*”.

Legal Representative. The estate of a deceased person vests in his legal representative (heir, executor etc). The legal representative can deal with the negotiable instruments belonging to the deceased to the same extent as the deceased could have done.

The legal representative who signs his name to a negotiable instrument must use words to indicate that he is not personally responsible (*e.g. sans recourse*). If he does not use any such words, he becomes personally responsible.—Sec. 29.

If a person indorses a negotiable instrument payable to order but dies before he can deliver the instrument to the indorsee, his legal representative cannot complete the transaction by delivering the instrument to the party intended to receive it. He must re-indorse the instrument, signing it as the legal representative, and then deliver it.—Sec. 57.

Joint Hindu Family. The *Karta* of a joint Mitakshara family can bind the joint family by executing a negotiable instrument provided the transaction is for the benefit of the family or is for legal necessity. The other members are bound to the extent of their shares in the joint family properties but are not liable personally.

LIABILITY OF THE PARTIES TO A NEGOTIABLE INSTRUMENT

The liability of the parties to a negotiable instrument is determined by the following rules :

Maker and Acceptor. The maker of a promissory note and the acceptor of a bill of exchange are primarily responsible for the payment due. Section 32 of the Act states that, in the absence of a contract to the contrary, the maker of a promissory note and acceptor of a bill of exchange before maturity are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively. The money must be paid at or after maturity to the holder as required. In default of such payment, the maker and the acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default.

Drawer. The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer.—Sec. 30.

Before acceptance the drawer's liability is primary, after acceptance, the drawer's liability is secondary, *i.e.* he is liable to pay only if the acceptor fails to pay.

Drawee of a Cheque. The drawee of a cheque having sufficient funds of the drawer, in his hands, properly applicable to the payment of such cheque must pay the cheque when duly required to do so, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default.—Sec. 31.

Cases where the drawee of a cheque can refuse payment.—See under "Banker and Customer" (Ch. 7).

Indorser. The indorser of a negotiable instrument is liable to all subsequent parties in case of dishonour of the instrument, provided (i) there is no contract to the contrary and (ii) the indorser had not limited or qualified his liability by using appropriate words and expressions for the purpose.—Sec. 35.

Every indorser after dishonour is liable as upon an instrument payable on demand.

The general rule regarding liability. The Principle of Suretyship.

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.—Sec. 36.

Maker, drawer and acceptor principals: The maker of a promissory note or cheque, the drawer of a bill of exchange until acceptance, and the acceptor are, in the absence of a contract to the contrary, respectively liable thereon as principal debtors, and the other parties thereto are liable thereon as sureties for the maker, drawer or acceptor, as the case may be.—Sec. 37.

Prior party a principal in respect of each subsequent party: As between the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party.—Sec. 38.

Illustration :

A draws a bill payable to his own order on B, who accepts. A afterwards indorses the bill to C, C to D, and D to E. As between E and B, B is the principal debtor; and A, C and D are his sureties. As between E and A, A is the principal debtor, and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety.

Suretyship: When the holder of an accepted bill of exchange enters into any contract with the acceptor which, under Section 134 or 135 of the Indian Contract Act, 1872, would discharge the other parties, the holder may expressly reserve his right to charge the other parties, and in such case they are not discharged.—Sec. 39.

The Extent of Liability. The compensation payable in case of dishonour of a negotiable instrument, by any party liable on the instrument, is determined by the following rules: (Sec. 117).

(a) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it;

(b) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;

(c) an indorser, who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at six per centum per annum from the date of payment until tender or realization thereof, together with all expenses caused by the dishonour and payment;

(d) when the person charged and such indorser reside at different places, the indorser is entitled to receive such sum at the current rate of exchange between the two places;

(e) the party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him. Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill.

The new bill given under clause (e) is known as *Redraft*.

PRESENTMENT FOR PAYMENT

A negotiable instrument must be presented for payment. The rules regarding presentation for payment are stated below :

Presentment of promissory note for sight : A promissory note, payable at a certain period after sight, must be presented to the maker thereof for sight (if he can, after reasonable search, be found) by a person entitled to demand payment, within a reasonable time after it is made and in business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default.—Sec. 62.

Presentment for payment : Promissory notes, bills of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder. In default of such presentment, the other parties thereto are not liable thereon to such holder.

Where authorised by agreement or usage, a presentment through the post office by means of a registered letter is sufficient.

Exception.—Where a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker thereof.—Sec. 64.

Hours for presentment : Presentment for payment must be made during the usual hours of business, and, if at a banker's, within banking hours.—Sec. 65.

Presentment for payment of instrument payable after date or sight : A promissory note or bill of exchange made payable at a specified period after date or sight thereon, must be presented for payment at maturity.—Sec. 66.

Presentment for payment of promissory note payable by instalments : A promissory note payable by instalments must be presented for payment on the third day after the date fixed for payment of each instalment ; and non-payment on such presentment has the same effect as non-payment of a note at maturity.—Sec. 67.

Presentment for payment of instrument payable at specified place and not elsewhere: A promissory note, bill of exchange or cheque made, drawn or accepted payable at a specified place and not elsewhere must, in order to charge any party thereto, be presented for payment at that place.—Sec. 68.

Instrument payable at specified place: A promissory note or bill of exchange, made, drawn or accepted payable at a specified place must, in order to charge the maker or drawer thereof, be presented for payment at that place.—Sec. 69.

Presentment where no exclusive place specified: A promissory note or bill of exchange, not made payable as mentioned in sections 68 and 69, must be presented for payment at the place of business (if any), or at the usual residence, of the maker, drawee or acceptor thereof, as the case may be.—Sec. 70.

Presentment when maker, etc., has no known place of business or residence: If the maker, drawee or acceptor of a negotiable instrument has no known place of business or fixed residence, and no place is specified in the instrument for presentment for acceptance or payment, such presentment may be made to him in person wherever he can be found.—Sec. 71.

Presentment of cheque to charge drawer: A cheque must, in order to charge the drawer, be presented at the bank upon which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer.—Sec. 72.

Presentment of cheque to charge any other person: A cheque must, in order to charge any person except the drawer, be presented within a reasonable time after delivery thereof by such person.—Sec. 73.

Presentment of instrument payable on demand: A negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.—Sec. 74.

Presentment by or to agent representative of deceased or assignee of insolvent: Presentment for acceptance or payment may be made to the duly authorized agent of the drawee, maker or acceptor, as the case may be, or where the drawee, maker or acceptor has died, to his legal representative, or, where he has been declared an insolvent, to his assignee.—Sec. 75.

Excuse for delay in presentment for acceptance or payment: Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When

the cause of delay ceases to operate, presentment must be within a reasonable time.—Sec. 75A.

When presentment for payment is not necessary. Presentment for payment is not necessary in the following cases. In all such cases the instrument is deemed to be dishonoured at the due date for presentment.—Sec. 76.

(a) If the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or,

if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or,

if the instrument being payable at some other specified place, neither he nor any person authorized to pay it attends at such place during the usual business hours, or,

if the instrument not being payable at any specified place, he cannot after due search be found ;

(b) as against any party sought to be charged therewith, if he has engaged to pay notwithstanding non presentment ;

(c) as against any party if, after maturity, with knowledge that the instrument has not been presented—

he makes a part payment on account of the amount due on the instrument,

or promises to pay the amount due thereon in whole or in part,

or otherwise waives his right to take advantage of any default in presentment for payment ;

(d) as against the drawer, if the drawer could not suffer damage from the want of such presentment.

LOST NEGOTIABLE INSTRUMENTS

The following rules are applicable in the case of lost negotiable instruments :

1. Where a bill of exchange has been lost before it is overdue, the holder of it may apply to the drawer to give him another bill of the same tenor, giving security to the drawer if required, to indemnify him against all persons in case the bill, alleged to have been lost, shall be found again. If the drawer on request refuses to give a duplicate, he may be compelled to do so.—Sec. 45A.

2. Before payment of a negotiable instrument, the person liable to pay is entitled to see the instrument and after payment he is entitled to have it delivered to him. If the document is lost or for any reason cannot be produced, he can refuse to pay. If he pays the holder of a

lost instrument he can demand to be indemnified against any further claim thereon against him.—Sec. 81.

3. The finder of a lost instrument gets no title. The rightful holder is entitled to get it back from him.

4. If a negotiable instrument, payable to bear or indorsed in blank, is lost and the finder negotiates it to a third party who takes it in good faith and for value, the third party becomes a holder in due course and is entitled to receive the amount due on the instrument from the parties liable to pay.

5. If a negotiable instrument payable to order is indorsed by the finder with a forged signature, the indorsee gets no title even though he might have taken it in good faith and for consideration. Forgery can confer no title. *Mercantile Bank of India v. Mascarenhas*.¹

6. If the party liable on a negotiable instrument pays the amount due on it to the person having it in his possession, under circumstances which makes the payment a payment in due course, he is discharged from all liabilities under the instrument. But the true owner can recover the money from the person who obtained payment. *Burne v. Morris*.²

7. When a negotiable instrument is lost, the holder should inform all parties liable on it and should also give public notice by advertisement.

INSTRUMENTS OBTAINED ILLEGALLY

The rules stated above regarding lost instruments apply to stolen instruments. A person who steals a negotiable instrument can get no rights upon it and the true owner can recover it from him. But if the instrument is negotiated under circumstances which make the transferee a holder in due course, he is entitled to receive payment on the instrument.

When an instrument is obtained by fraud, coercion, undue influence or by any illegal means, the title of the receiver is defective and he cannot claim anything on the instrument. But if the document is transferred to a holder in due course, the latter gets a good title and is entitled to receive payment. The same rule applies if the consideration originally paid for the instrument was unlawful.

If an acceptance is procured by fraud, the acceptor is liable to the holder in due course and to nobody else. *Ayres v. Moore*.³

¹ (1932) P. C. 22

² (1834) 2 Cr. & M. 579

³ (1940) 1 K. B. 278

FORGED INSTRUMENTS

If the signature on a negotiable instrument is forged, the document is invalid and cannot confer any right or create any liability.

But the acceptor of a bill of exchange, already indorsed, is not relieved from liability by reason that such indorsement is forged, if he knew or had reason to believe the indorsement to be forged when he accepted the bill.—Sec. 41.

If in an instrument payable to order, there is a forged indorsement, the indorsee gets no title.

If in a bearer instrument or in an instrument indorsed in blank, there is a forged indorsement, the holder gets a good title. The reason is that in such instruments the holder derives title by delivery and not through any indorsement. The forged indorsement is therefore immaterial.

INSTRUMENT WITHOUT CONSIDERATION

A negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if the instrument is transferred to a holder for a consideration, such holder and all persons deriving title from him, can recover the amount due from the transferor for consideration, or any prior party thereto.—Sec. 43.

When there is a partial failure of consideration, the parties standing in immediate relation to each other cannot recover more than the actual consideration. But this rule does not apply to a holder in due course.—Sections 44 and 45.

Example :

P makes a promissory note for Rs. 500 in favour of *Q* who pays him Rs. 400, promising to pay Rs. 100 later. *Q* cannot recover from *P* more than Rs. 400. But if *Q* indorses the note to *R* for consideration, *R* can recover from *P* Rs. 500.

DISCHARGE OF PARTIES FROM LIABILITY

The liability of a party to a negotiable instrument may be discharged or terminated in any of the following ways:

1. *By payment in due course of the amount due.* Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person

in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment.—Sections 10, 82 (c) and 85.

2. *By the holder discharging or releasing the maker, acceptor or indorser.*—Sec. 82 (b).

3. *By cancellation of a party's name by the holder.*—Sec. 82 (a). If the holder strikes out the name of a person from a negotiable instrument and indorses it, the person whose name is cancelled is discharged from liability.

Where the effect of such cancellation is to impair any indorser's remedy against a prior party, the indorser is discharged from liability, unless the cancellation is made with the consent of such indorser.—Sec. 40.

Example .

A is the holder of a bill of exchange made payable to the order of B, which contains the following indorsements in blank :

First indorsement—B

Second " —Peter Williams

Third " —Wright & Co.

Fourth " —John Rozario.

This bill A puts in suit against John Rozario and strikes out, without Rozario's consent, the indorsements of Peter Williams and Wright & Co. A is not entitled to recover anything from Rozario.

4. *By default of the holder.*

(a) If the holder allows more than 48 hours time to the drawee for deliberation, all prior parties not consenting to the extra time, are discharged from liability.—Sec. 83.

(b) If the holder agrees to a qualified acceptance, all prior parties not consenting to such acceptance are discharged from liability.—Sec. 86.

(c) All parties to whom the holder does *not* send notice of dishonour, are discharged from liability, unless the circumstances are such that no notice of dishonour is required to be sent.

(d) Where a bill of exchange is required to be accepted but the holder does not present it for acceptance within due time, no party to the bill is liable thereon to the person making such default.—Sec. 61.

(e) Where a negotiable instrument is required to be presented for payment and it is not so presented in proper time by the holder, the other parties to the instrument are not liable thereon to such holder.—Sec. 64.

(f) If the holder of a cheque does not present it for payment

within reasonable time and, as a result, the drawer of the cheque suffers damage, he is discharged from his liability to the extent of the damage.—Sec. 84.

5. *By Material Alteration.*

“Any material alteration of a negotiable instrument renders the same void as against any one who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties; and any such alteration, if made by an indorsee, discharges his indorser from all liability to him in respect of the consideration thereof.”—Sec. 87.

The rule, regarding material alteration, is subject to certain limitations. (See below).

MATERIAL ALTERATION

A material alteration is one,

- (i) which substantially changes the *rights and liabilities* of the parties, or any of the parties, to the instrument, or,
- (ii) which changes the *identity and the legal character* of the instrument.

Changes in the following items are considered to be material alteration : amount of money payable ; date and time of payment ; rate of interest ; addition of a party ; the medium of payment.

It has been held in English cases that an alteration by a stranger, if it is material, will avoid the instrument. The Madras High Court, however, has held that an alteration made by a stranger does not make the instrument invalid.⁴

As regards the effect of alteration, a distinction must be made between persons who are parties to the instrument at the time when the alteration is made and persons who become parties subsequently. A material alteration discharges the liabilities of persons who are parties at the time when the alteration is made. Persons who become parties to the instrument after the alteration, are liable under the instrument as altered. Section 88 of the Act lays down that an acceptor or indorser of a negotiable instrument is bound by his acceptance or indorsement notwithstanding any previous alteration of the instrument.

⁴I. L. R. (1941) Mad 295

Alterations allowed by law. An alteration which is the result of an accident does not affect the validity of an instrument. The Judicial Committee of the Privy Council in *Hongkong & Shanghai Banking Corporation v. Lo Lee Shi*⁵ held that, in order to invalidate an instrument the alteration must be one effected by the will of the person by whom or under whose direction it is made. Thus accidental alterations do not render a document invalid. In English cases it has been held that alterations in a document brought about by the following causes do not affect its validity: mutilation by the washing and ironing of a garment in which the document was kept; ravages of white ants or rats; document torn by a child; document burnt in part by accident.

An alteration made before the completion of the instrument does not affect its validity. Thus if a person strikes out the word "order" from a printed cheque form and substitutes the word "bearer" before issuing the cheque, it is a valid bearer cheque. Such alterations should be initialled by the person executing the instrument, in order to indicate that the alteration was made before the instrument became effective.

After an instrument is executed, it may be altered in certain ways without affecting the validity of the instrument. Alterations of the following type are permitted by law:

1. An alteration made with the consent of all parties.
2. Alterations made in order to carry out the common intention of the original parties. Such alterations include correction of a clerical error or accidental slips.
3. Completing an inchoate stamped instrument.—Sec. 20.
4. Conversion of an indorsement in blank into an indorsement in full.—Sec. 49.
5. The crossing of an uncrossed cheque, conversion of general crossing to special crossing, addition of words like "not negotiable" to a crossed cheque.—Sec. 125.
6. A note on the margin of an instrument is not necessarily a part of the instrument. If it is not a part of the instrument it can be altered without affecting the validity of the instrument. It has been held that the addition, in the margin, of a mere statement of fact which is not covered by the signature is not a material alteration. *Ede v. K. N. Shaw*.⁶

⁵ (1928) A. C. 181

⁶ 3 Cal. 220

EXERCISES

1. Examine to what extent can a minor be a party to a negotiable instrument. (C.A., May '58, Nov. '60)
2. Explain what is meant by a material alteration in a negotiable instrument. What is the effect of such alteration? Give examples. (C.A., May '58)
3. How far does the alteration of a bill of exchange affect the rights of (i) existing parties to the bill and (ii) subsequent endorsers? Also state whether it is material to the validity of a bill if there is an alteration in (a) the date (b) the place of payment and (c) the figures in the margin. (C.U. '55)
4. What is presentment? When is presentment for payment unnecessary in the case of negotiable instruments? (C.A., May '53)
5. What is meant by negotiation of a Negotiable Instrument? State what are the rights and liabilities of the parties to Negotiable Instruments. (C.U. '60)
6. What is the effect of fraud and forgery on a negotiable instrument? (C.A., May '54)
7. Examine the different modes of discharge of liability of parties to a negotiable instrument. (C.A., May '59)

CHAPTER 4

DISHONOUR OF A NEGOTIABLE INSTRUMENT

A negotiable instrument may be dishonoured in two ways: (i) by non-acceptance and (ii) by non-payment. Only bills of exchange can be dishonoured by non-acceptance, since only bills require acceptance. Promissory notes, bills of exchange and cheques can be dishonoured by non-payment.

Dishonour by Non-acceptance. A bill of exchange is *dishonoured by non-acceptance* in the following cases :

1. When after due presentation, the bill is not accepted by the drawee. When there are several drawees (who are not partners) refusal by any one of the drawees will amount to dishonour.

2. In cases where presentation for acceptance is excused, the bill is treated as dishonoured if it is not accepted without presentation.

3. Where the drawee is incompetent to contract, the bill may be treated as dishonoured.—Sec. 91.

4. If the acceptance is qualified, the bill may be treated as dishonoured.

5. Where a drawee in case of need is named in a bill, or in any indorsement thereon, the bill is not dishonoured until it has been dishonoured by such drawee.—Sec. 115

Dishonour by Non-payment. A promissory note, bill of exchange or cheque is *dishonoured by non-payment* when the maker of the note or the acceptor of the bill of exchange or the drawee of the cheque makes default in payment upon being duly required to pay the same.—Sec. 92.

Consequence of dishonour. When a negotiable instrument is dishonoured, the holder becomes entitled to file a suit for the recovery of the amount due from the parties liable to pay. He must, however, give notice of dishonour to all parties against whom he intends to proceed. He may also have the instrument noted and protested before a notary public.

NOTICE OF DISHONOUR

Notice of dishonour means the notice which must be given by the holder of a dishonoured instrument to all parties liable to pay the amount due on the instrument.

Rules regarding the notice of dishonour. (Sections 93-97).

1. Notice is to be sent to the party liable, or his duly authorised agent; if he is dead it is to be given to his legal representative; if he is insolvent it is to be given to the Official Assignee. The agent of the holder can give notice.

2. The notice may be oral or written. If written it may be sent by post. A notice duly addressed and posted is good even though it may be miscarried.

3. The notice may be in any form; but the language used must indicate that the instrument has been dishonoured and that the party to whom notice is being given will be held liable thereon.

4. The notice must be sent to the place of business of the party or (where he has no place of business) to his residence.

5. The notice must be sent within a reasonable time after dishonour. (See *ante* for the definition of reasonable time.)

6. A party receiving notice of dishonour should, if he wishes to make a prior party liable, send a similar notice to the prior party or parties, unless such prior party receives notice otherwise.

7. When the party to whom notice is sent is dead, but the party sending notice is ignorant of the fact, the notice is sufficient to bind the estate of the deceased.

Consequence of not sending notice of dishonour. Any person to whom notice of dishonour is not sent is discharged from his obligations under the instrument. He is not liable to pay and no suit can be filed against him.

When notice of dishonour need not be given. It is not necessary to give notice of dishonour in the cases, and to parties, mentioned below. In these cases, the parties are liable without any notice.—Sections 93, 98.

1. To the maker of a dishonoured promissory note.

2. To the drawee or acceptor of a dishonoured bill of exchange or cheque.

3. When it is dispensed with by the party entitled thereto.

4. In order to charge the drawer when he has countermanded payment.

5. When the party charged could not suffer damage for want of notice.

6. When the party entitled to notice cannot after due search be found; or the party bound to give notice is, for any other reason, unable without any fault of his own to give it.

7. To charge the drawers when the acceptor is also a drawer.

8. In the case of a promissory note which is not negotiable.

9. When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

NOTING

When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each.

Such note must be made within a reasonable time after dishonour, and must specify the date of dishonour, the reasons, if any, assigned for such dishonour, or, if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary charges.—Sec. 99.

Advantages of Noting: Noting a promissory note or bill of exchange is a convenient method of recording the fact of dishonour. If a suit is subsequently filed on the instrument, the notary public may give evidence about presentment and dishonour. A bill of exchange may be accepted for honour and paid for honour after it is noted.

Noting (and protest) is not compulsory. The procedure is not applicable to cheques.

PROTEST

Protest. When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a Protest.—Sec. 100.

Protest for Better Security. When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused may, within a reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a Protest for Better Security.—Sec. 100.

Contents of protest. A protest must contain the following particulars.—(Sec. 101):

- (a) either the instrument itself, or a literal transcript of the instrument and of everything written or printed thereupon;
- (b) the name of the person for whom and against whom the instrument has been protested;

- (c) a statement that payment or acceptance, or better security, as the case may be, has been demanded of such person by the notary public; the terms of his answer, if any, or a statement that he gave no answer, or that he could not be found;
- (d) when the note or bill has been dishonoured the place and time of dishonour, and, when better security has been refused, the place and time of refusal;
- (e) the subscription of the notary public making the protest;
- (f) in the event of an acceptance for honour or of a payment for honour, the name of the person by whom, of the person for whom, and the manner in which such acceptance or payment was offered and effected.

A notary public may make the demand mentioned in clause (c) above either in person or by his clerk or, where authorized by agreement or usage, by registered letter.

Notice of protest. When a promissory note or bill of exchange is required by law to be protested, notice of such protest must be given instead of notice of dishonour, in the same manner and subject to the same conditions; but the notice may be given by the notary public who makes the protest.—Sec. 102.

Protest is compulsory in the case of a foreign bill, if it is so provided by the law of the place where it is drawn. For inland bills protest is optional.—Sec. 104.

When noting is equivalent to protest. Where a bill or note is required to be protested within a certain time or proceeding, it is sufficient if the bill or note is noted within that time or proceeding; the formal protest may be issued later.—Sec. 104A.

The Difference between Noting and Protest. Noting is merely a record of the fact of dishonour. When the notary public issues a certificate stating the particulars regarding the dishonour, it is called a Protest.

NOTARY PUBLIC

The Notary Public is an officer appointed by the Government to exercise the functions of a Notary Public as laid down in the Negotiable Instruments Act (Noting, Protest etc.). Formerly, Notaries Public used to be appointed by the State Government. Now, the 'Notaries Act of 1952 governs the profession of notaries. Under

Section 15 of this Act, the Central Government is empowered to frame rules concerning the appointment, removal and functions of notaries.

ACCEPTANCE FOR HONOUR

When a bill of exchange has been noted or protested for non-acceptance or for better security, any person not already liable on the bill, may accept the bill for the honour of any party thereto.—Sec. 108.

Rules regarding Acceptance for Honour.

1. Consent of the holder is necessary before a bill can be accepted for honour.—Sec. 108.

2. The acceptor for honour must, by writing on the bill in his own hand, declare that he accepts under protest the protested bill for the honour of the drawer or of a particular indorser whom he names, or generally for honour.—Sec. 109.

3. Where the acceptance does not express for whose honour it is made, it shall be deemed to be made for the honour of the drawer.—Sec. 110.

4. An acceptor for honour binds himself to all parties subsequent to the party for whose honour he accepts to pay the amount of the bill if the drawee does not : and such party and all prior parties are liable in their respective capacities to compensate the acceptor for honour for all loss or damage sustained by him in consequence of such acceptance.—Sec. 111, para 1.

But an acceptor for honour is not liable to the holder of the bill unless it is presented (or in case the address given by such acceptor on the bill is a place other than the place where the bill is made payable), forwarded for presentment, not later than the day next after the day of its maturity.—Sec. 111, para 2.

5. An acceptor for honour cannot be charged unless the bill has at its maturity been presented to the drawee for payment, and has been dishonoured by him, and noted or protested for such dishonour.—Sec. 112.

PAYMENT FOR HONOUR

When a bill of exchange has been noted or protested for non-payment, any person may pay the same for the honour of any party liable to pay the same. Such payment is called payment for honour.

The person paying for honour or his agent must declare before

a notary public the name of the party for whose honour he is paying. The notary public must record the declaration.—Sec. 113.

Any person paying for honour is entitled to all the rights of the holder of the bill at the time of the payment. He may recover from the party for whose honour he pays, all sums so paid, with interest thereon and with all expenses properly incurred in making such payment.—Sec. 114.

A drawee in case of need may accept and pay the bill of exchange without previous protest.—Sec. 116.

EXERCISES

1. What is acceptance for honour? How must acceptance for honour be made? What are the liabilities of an acceptor for honour? (C.U. '51)
2. (a) What is meant by dishonour for non-acceptance and dishonour for non-payment?
(b) State the cases in which notice of dishonour is not necessary. (C.U. '58)
3. When is a negotiable instrument considered as dishonoured? What are the duties of a holder upon such dishonour? (C.U. '59)
4. What is meant by 'payment for honour' and what are its peculiar features? (C.A. 1954)

CHAPTER 3

RULES OF EVIDENCE. INTERNATIONAL LAW

PRESUMPTIONS AS TO NEGOTIABLE INSTRUMENTS

The Negotiable Instruments Act lays down certain rules of evidence regarding negotiable instruments. Section 118 provides that in a suit upon a negotiable instrument, the court can presume the following :

- (a) that every negotiable instrument was made or drawn for consideration, and that every such instrument, when it has been accepted, indorsed, negotiated or transferred, was accepted, indorsed, negotiated or transferred for consideration ;
- (b) that every negotiable instrument bearing a date was made or drawn on such date ;
- (c) that every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity ;
- (d) that every transfer of a negotiable instrument was made before its maturity ;
- (e) that the indorsements appearing upon a negotiable instrument were made in the order in which they appear thereon ;
- (f) that a lost promissory note, bill of exchange or cheque was duly stamped ;
- (g) that the holder of a negotiable instrument is a holder in due course : Provided that where the instrument has been obtained from its lawful owner, or from any person in lawful custody thereof, by means of an offence or fraud, or has been obtained from the maker or acceptor thereof by means of an offence or fraud, or for unlawful consideration, the burden of proving that the holder is a holder in due course lies upon him.

Section 119 provides that in a suit upon an instrument which has been dishonoured, the Court shall, on proof of the protest, presume fact of dishonour, unless and until such fact is disproved.

Any of the presumptions can be rebutted by evidence to the contrary. The effect of Sections 118 and 119 is to throw the burden of proof upon the party alleging anything contrary to the allowable presumptions. Thus in a suit on a promissory note, if the defendant alleges that there was no consideration, it is his duty to prove it. The plaintiff need not prove consideration because the court will, according to Section 118 (a), presume that consideration was paid. In an ordinary money suit, however, it is the plaintiff's duty to prove consideration.

ESTOPPEL

The Negotiable Instruments Act lays down the following rules of estoppel :

1. **Estoppel against denying original validity of instrument:** No maker of a promissory note, and no drawer of a bill of exchange or cheque, and no acceptor of a bill of exchange for the honour of the drawer shall, in a suit thereon by a holder in due course, be permitted to deny the validity of the instrument as originally made or drawn.—Sec. 120.

2. **Estoppel against denying capacity of payee to indorse:** No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or bill, to indorse the same.—Sec. 121.

3. **Estoppel against denying signature or capacity of prior party:** No indorser of a negotiable instrument shall, in a suit thereon by a subsequent holder, be permitted to deny the signature or capacity to contract of any prior party to the instrument.—Sec. 122.

INTERNATIONAL LAW

When a negotiable instrument is made or drawn in one country but is payable in another country, the question arises : by the law of which country will the instrument be governed? The Negotiable Instruments Act contains the following rules on the subject :

1. For a foreign bill, in the absence of a contract to the contrary the liability is determined as follows : (Sec. 134).

Maker or Drawer—by the law of the place where the instrument is made.

Acceptor and Indorser—by the law of the place where the instrument is payable.

Example :

A bill of exchange was drawn by A in California where the rate of interest is 25 per cent. and accepted by B, payable in Washington, where the rate of interest is 6 per cent. The bill is indorsed in India, and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6 per cent. only; but, if A is charged as drawer, A is liable to pay interest at the rate of 25 per cent.

2. Where a promissory note, bill of exchange or cheque is made payable in a different place from that in which it is made or indorsed, the law of the place where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient.—Sec. 135.

Example :

A bill of exchange drawn and indorsed in India, but accepted payable in France, is dishonoured. The indorsee causes it to be protested for such dishonour and gives notice thereof in accordance with the law of France, though not in accordance with the rules of Indian law. The notice is sufficient.

3. If a negotiable instrument is made, drawn, accepted or indorsed out of India, but in accordance with the law of India, the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or indorsement made thereon in India.—Sec. 136.

4. The law of any foreign country regarding promissory notes, bills of exchange and cheques shall be presumed to be the same as that of India, unless and until the contrary is proved.—Sec. 137.

EXERCISES

1. Enumerate the presumptions which shall be made with reference to negotiable instruments, until the contrary is proved. (C.A. May '60).
2. What are the rules of international law concerning negotiable instruments ?

CHAPTER 6

HUNDIS

DEFINITION

Indian merchants and indigenous bankers use various kinds of negotiable instruments written in Indian languages. Such instruments are known as Hundis.

There is evidence to show that Hundis were discovered by Hindu merchants and bankers in ancient India. The term Hundi comes from the Sanskrit word "Hund" which means "to collect".

THE LAW APPLICABLE TO HUNDIS

The Negotiable Instruments Act does not apply to Hundis. A Hundi is governed by the custom and usages of the locality in which it is intended to be used. In case of dispute, the court takes evidence of local usages and applies them. If, on a certain point, there is no customary rule the court can apply the rules of the Negotiable Instruments Act.

The parties may, by express writing on a Hundi, agree that in case of dispute on that Hundi, the customary rules shall be excluded and that the provisions of the Negotiable Instruments Act shall apply.

TYPES OF HUNDIS

By long usage various types of Hundis have been evolved. The principal types are described below.

Shah Jog Hundi. A Shah Jog Hundi is one which is payable only to a Shah. Shah means a respectable holder *i.e.* a man of money, well known to the market. A Shah Jog Hundi may be transferred from one person to another by delivery: no indorsement is required, but it will not be paid to anybody other than a Shah. No acceptance is required. A Shah Jog Hundi is similar to a crossed cheque.

Nam Jog Hundi. A Nam Jog Hundi is one which is payable to the party named in the Hundi or according to his order.

Firman Jog Hundi. A Firman Jog Hundi is one which is payable to the order of the holder.

Dhani Jog or Dekhandar Hundi. These are Hundis payable to bearer.

Jawabee Hundi. A Jawabee Hundi is one through which money is remitted from one place to another. The person receiving the money has to send an answer or 'Jawab' to the remitter.

Jokhmi Hundi. A Jokhmi Hundi is a combination of bill of exchange and insurance policy. By a Jokhmi Hundi the seller of goods calls upon the buyer of goods to pay the value of the goods to the holder of the Hundi. In form the Hundi is similar to a bill of exchange. The buyer of goods accepts the Hundi subject to the condition that he will pay the money mentioned in the Hundi only if he receives the goods. The seller of goods (*i.e.* the drawer of the Hundi) discounts the Hundi with a third party, who may be called the insurer. The third party pays to the drawer of the Hundi, the value of the Hundi less an amount calculated to be equal to the insurance premium payable for the risks involved in the carriage of the goods from the seller to the buyer. If the goods reach the buyer safely, the insurer becomes entitled to receive the full value of the Hundi from the buyer. If the goods are lost in transit, he gets nothing. Thus the insurer takes the risk of loss of goods during carriage.

A Jokhmi Hundi is advantageous to the seller of goods because he gets the purchase price (less insurance premium) immediately. It is also advantageous to the buyer because he incurs no liability unless he receives the goods.

General Terms. There are certain general terms applicable to all types of Hundis. Hundis payable at sight are called *Darshani Hundis*. Hundis payable after a specified period are called *Madi* or *Muddati Hundis*. A Hundi paid up and cancelled is called *Khokha*. Sometimes a Hundi is accompanied with a letter written by the drawer or any other prior party addressed to some respectable person requesting him to pay the amount due on the Hundi in case the drawee fails to pay. Such a letter is known as the *Zickri Chit* or the *Tickri Chit*. It is a procedure for protecting the holder against non-payment. The person to whom the letter is addressed, acts somewhat like an acceptor for honour. But he will pay the money without prior noting or protest. The provisions of the Negotiable Instruments Act regarding noting and protest do not apply to Hundis.

The term *Peth* is sometimes used to denote the duplicate of a Hundi given when the original is lost. The duplicate of a duplicate is called *Perpeth*.

CHAPTER 7

BANKERS AND CUSTOMERS

The law relating to banking in India is contained in the following statutes :

1. The Indian Contract Act and the Negotiable Instruments Act.
2. The Indian Companies Act and the Banking Companies Act.

The first two Acts contain the rules regulating the relationship between the banker and the customer and the last two deal with the organisational aspects of banking, *i.e.* rules regarding the structure, constitution and control of banks. As regards the relationship between the banker and customer, the Indian statutes are not comprehensive. The courts apply rules of English common law to decide points not fully covered by the Indian Acts.

Definition of Banking. The Banking Companies Act of 1949 defines *banking* as, "accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, or otherwise." A *banking company* is defined by the Act as a company registered under the Companies Act and carrying on the business of banking. Industrial enterprises accepting deposits for finance, are expressly excluded from the definition of banking companies. The Act provides that banking companies must take out a licence from the Reserve Bank of India. An unlicensed company or firm cannot use the word Bank, Banker or Banking as a part of its name.

Banker and the Customer. There are conflicting judicial decisions on the definition of the term "customer of a bank." The prevailing opinion is that a customer is one who has an account with the bank in question or one who uses the services of the bank. The time period of the relationship is not important. But a casual service, *e.g.* cashing a cheque for a friend of a customer, does not create the relationship of banker and customer. There must be some element of regularity or permanence.

Subject to the rules laid down in the Negotiable Instruments Act regarding the duties and liabilities of banks, the relationship between the banker and his customer is regulated by contract between them. The terms of the contract between the parties are to be found (i) in

the rules and regulations of the bank notified to the customer at the time when an account is opened and (ii) from the course of dealings between the parties where such dealings have taken place for some time.

As regards moneys deposited by the customer, the banker is the debtor and the customer is the creditor. The reverse is the position as regards moneys lent by the bank to the customer.

A bank may, by agreement with his customer, undertake various duties on behalf of the latter. The two most important duties are :

1. To honour cheques drawn by the customer.
2. To collect cheques and drafts on behalf of the customer.

The Negotiable Instruments Act lays down certain rules regarding the two above duties. The rules are stated below.

PAYMENT OF CHEQUES BY BANKS

Section 31 of the Negotiable Instruments Act provides that, "The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default."

It follows from the above that the banker is bound to pay a cheque drawn by a customer provided the following conditions are satisfied :

1. There must be sufficient funds to the credit of the drawer. But if there is an overdraft arrangement, the cheque must be paid even though there is no fund, provided the amount drawn comes within the arrangement. If a bank has branches, the cheque must be on the branch where the account is. When a customer deposits cheques or drafts for collection, he cannot draw cheques on the amount to be collected until after a reasonable time has been given to the bank for collecting it.

2. The funds must be properly applicable to the payment of the cheque. An account for one purpose cannot be drawn upon for another purpose—*e.g.* a trust account cannot be drawn upon in the personal capacity of the trustee. If the account is subject to any limits as regards drawing (*e.g.* one cheque per week or 50% of the balance) the cheque must be within these limits.

3. The bank must be *duly* required to pay the cheque. The cheque must be properly drawn and presented within the usual bank-

ing hours. The signature of the drawer must be identical with his specimen signature kept with the bank. The cheque must not be post-dated or stale and must not contain unsigned alterations.

A banker may refuse to pay a customer's cheque under the following circumstances :

1. If there are insufficient funds of the drawer and there is no overdraft arrangement.

2. If the cheque is not properly drawn *e.g.* if it is ambiguous or illegible or contains unsigned alterations or if the signature does not tally with the specimen signature of the drawer or if it is undated or post-dated or stale or otherwise irregular.

3. If the cheque is not presented at the branch in which the customer has an account and within banking hours.

4. If the bank has a claim for a set off or a lien on the funds of the customer, the bank may refuse to pay any cheque in excess of the balance above the claim or lien.

Under the following circumstances a banker must refuse to pay a cheque :

1. If the customer countermands payment, *i.e.*, instructs the banker not to pay. The instructions countermanding payment must be properly communicated to the bank. *Curtice v. London City and Midland bank.*¹

2. If after the issue of a cheque the customer dies and the bank receives notice of the death. The same rule applies in case of lunacy of the drawer.

3. If the bank receives notice of the insolvency of the customer. Upon insolvency a person loses the right to deal with his money and properties.

4. In the case of a cheque drawn by a company, if the bank receives notice of a winding up order against the company.

5. If the bank is served with a garnishee order or if the moneys of the customer are attached in execution of a decree of a court. (A garnishee order is an order by the court directing a person, having in his custody money belonging to another, to pay the money to some other person.)

6. If the drawer informs the bank that the cheque is lost.

Liability of the banker. A banker is entitled to refuse to pay a customer's cheque only in the cases mentioned above. If the banker

¹ (1908) 1 K.B. 293

dishonours a customer's cheque without justification he is liable to pay damages to the customer. Only the customer is entitled to sue, not the holder or the payee. But where the banker admits to the holder that the customer has money or contracts with him to pay it, the holder may sue. The reason why the holder cannot sue (except under special circumstances) is that the drawing of a cheque does not operate as an assignment of money and the holder cannot claim to sue as an assignee.

The wrongful dishonour of a cheque amounts to a breach of contract on the part of the banker. It also injures the credit of the customer in the market and therefore amounts to a libel. The customer is entitled to damages on both these grounds.

Formerly heavy damages used to be awarded for wrongful dishonour of a cheque. In recent times the tendency is to limit damages to the actual injury suffered, except in the case of trader's cheques where substantial injury is presumed.

When a cheque is improperly paid, the customer's account cannot be debited with the payment and the banker will have to bear the loss.

Protection given to a paying banker. A banker is protected if a cheque is paid under circumstances which makes the payment, "a payment in due course" as defined in Section 10 of the Negotiable Instruments Act.

"Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned."—Sec. 10.

When payment is made in due course, the customer's account can be debited with the money paid. The banker is not liable even if it subsequently transpires that payment has been made to the wrong person (*e.g.* where the holder has obtained the cheque dishonestly).

Where a cheque payable to order purports to be endorsed by or on behalf of the payee the drawee is discharged by payment in due course.—Sec. 85 (1).

Where a cheque is originally expressed to be payable to bearer the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.—Sec. 85 (2). This

section lays down the rule, "once a bearer cheque, always a bearer cheque". (See *ante*).

In the case of a crossed cheque, the liability of the paying bank is discharged by payment in due course to the bank presenting the cheque for payment. It is not the duty of the paying bank to see that the money reaches the true owner.—Sec. 128.

Forged Cheques: A cheque, with the drawer's signature forged, is a nullity and if a bank pays such a cheque to the customer is not liable and his account cannot be debited with the payment. It has been held in several cases that a banker is expected to know his customer's signature.

Cheques with alterations: An alteration which is countersigned or initialled by the drawer is immaterial. But an unsigned alteration of a material part of a negotiable instrument makes it invalid. A banker, however, is protected if he pays a cheque with alterations under the following circumstances: (i) if the alteration is not apparent and (ii) if the payment is according to the apparent tenor of the instrument.—Sec. 89.

Therefore, where the alteration is noticeable on reasonable scrutiny and the banker pays the money, he is not entitled to debit the customer's account with the payment.

In some English cases it has been held that the customer owes a duty to his bank not to do anything which will facilitate subsequent alterations or forgery and where the customer is guilty of facilitating such forgery or alterations, he is estopped from denying his liability to be debited with the payment. *Examples of negligence by customer:* keeping a blank space between the name of the payee and the expression "or order" or before and after the figures: not keeping the cheque book under lock and key.

COLLECTION OF CHEQUES AND DRAFTS

A customer may deposit a cheque or draft in his bank for collection or may negotiate it to the bank. In the latter event, the bank becomes the indorsee of the instrument and if it is dishonoured the loss falls on the bank. If however a cheque or draft is deposited for collection only, the bank becomes the agent of the customer and in case of dishonour the loss falls upon the customer. Whether in a particular case the bank is indorsee or merely agent for collection, depends on the circumstances of the case.

When a bank acts as the agent for collection it has certain duties

to perform. It must exercise due diligence, *i.e.* present the instrument for payment within reasonable time. What is reasonable time depends upon the circumstances of the case. In some English cases it has been held that for bankers in the same town, one day is reasonable time; for places outside the town, the cheque must be forwarded for collection within one day. If for failure to present the cheque within reasonable time the customer suffers damage, the bank is liable. If the instrument deposited for collection is dishonoured, the banker must inform the customer.

A bank may collect bills of exchange on behalf of a customer. In such cases it must present the bills for acceptance and payment within reasonable time and must give due notice of dishonour if necessary.

If a cheque is negotiated to the bank by the customer, it becomes the owner of the cheque and can enjoy the protection afforded to the holder in due course in appropriate cases.

Protection given to Collecting Bankers. Section 131 of the Negotiable Instruments Act provides as follows:

“A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason of having received such payment.

Explanation—A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof.”

The meaning of the aforesaid section is that if it turns out that the customer depositing a cheque had no title to the money, the collecting bank is not liable to pay compensation to the true owner, provided the following conditions are satisfied:

1. The collecting bank acted in good faith and without negligence. The existence of any suspicious circumstance puts the bank upon enquiry and the absence of enquiry amounts to negligence and want of good faith.
2. The collecting bank must have been acting on behalf of a customer, *i.e.* a person having an account with the bank or dealing regularly with it.
3. The cheque in question was a crossed cheque.

4. The bank was acting as agent for collection and was not an indorsee of the cheque.

The explanation makes it clear that a bank may credit the customer with the amount of the cheque before collection and that such prior credit is immaterial to the question of the liability of the bank to the true owner.

BANKER'S DRAFTS

Banker's drafts are of two kinds : (i) from one office to another of the same bank and (ii) from one bank to another. The first type cannot be payable to a bearer on demand (Section 31 of the Reserve Bank of India Act). Section 131A of the Negotiable Instruments Act provides that a draft drawn by one branch of a bank upon another and payable to order, is governed by the same rules as a cheque.

EXERCISES

1. Discuss the law relating to crossed cheques with special reference to the liabilities of the collecting bank in respect thereof. (C.A., May '50).

2. Enumerate the circumstances under which a banker can refuse to honour a customer's cheque. (C.A., May '51; Nov. '52).

3. Discuss the liabilities of a collecting bank in respect of cheques, (C.A., Nov. '53).

4. Discuss the circumstances under which a banker receiving payment of a cheque is protected. (C.A. Nov. '59).

BOOK VII

THE LAW RELATING TO CARRIAGE

CHAPTER I

INTRODUCTION

The law relating to carriage may be studied under three heads : (i) Carriage by Land, including inland navigation (ii) Carriage by Sea and (iii) Carriage by Air. This is a convenient classification because these three branches of the law of carriage are governed by different principles and different statutes.

Indian statutes relating to the law of carriage are mentioned below :

1. Carriage by Land :—(i) the Common Carriers Act, 1865, which deals with *common* carriers of *goods* over land and inland waterways.
(ii) The Railways Act, 1890, which deals with carriage by railways.
2. Carriage by Sea :—(i) The Indian Bills of Lading Act, 1856.
(ii) The Carriage of Goods by Sea Act, 1925.
3. Carriage by Air :—Carriage by Air Act, 1934.

The statutes mentioned above are not exhaustive. On all points not specifically covered by them, Indian courts apply principles of English law as rules of equity and good conscience.

CLASSIFICATION OF CARRIERS

Carriers may be classified into carriers of goods and carriers of passengers. The same carrier may of course carry both goods and passengers.

It is more usual to classify carriers into Common Carriers and Private Carriers.

Common Carriers. In English law a common carrier is defined as one who undertakes to carry for hire, from place to place, the goods of anyone who employs him. The essential feature of a common carrier, according to English law, is that he is prepared to carry the goods of anyone without discrimination. If a carrier reserves to himself the right to reject an offer (even if there is accommodation in the carriage and the offeror is prepared to pay the usual freight) he is

not a common carrier. *Belfast Ropework Co. v. Bushell*.¹

In Indian law the term common carrier is used in a restricted sense. The Common Carriers Act of 1865 defines a common carrier as any individual, firm, or company (other than the government) who transports goods, as a business, for money, over land or inland waterways, without discrimination between different consignors. Thus the characteristics of a common carrier in India are as follows :

1. It may be a firm or an individual or a company. But the government is not included in the category. The post office is not a common carrier, although it may carry goods.

2. Only carriers of goods come within the definition. A carrier of passengers is not a common carrier.

3. A common carrier is one who carries goods as a matter of business for money. From this it follows that one who carries goods occasionally is not a common carrier. Also, one who carries goods free is not a common carrier.

4. A common carrier is one who is ready to carry the goods of any person without any discrimination.

5. The term common carrier is applied only in the case of carriage by land and over inland waterways.

Private Carrier. A private carrier is one who does *not* do regular business as a carrier but occasionally carries goods for money. Suppose that a contractor has a lorry which he uses mainly for transporting his own goods but sometimes he lets it out on hire to others. The contractor is a private carrier. From the occasional nature of a private carrier's job, it follows that he can discriminate between different hirers. He is not bound to carry the goods of any and everybody. A common carrier (subject to certain exceptions) is bound to do so.

Differences between a common carrier and a private carrier.

1. A common carrier is one whose business is carriage of goods for hire. A private carrier is an occasional carrier.

2. A common carrier is bound to carry the goods of any person who is ready to pay the usual freight, provided certain conditions (relating to space, type of goods etc.) are fulfilled. A private carrier is free to carry goods or not as he pleases.

3. The liabilities of a common carrier are determined by the Common Carriers Act, 1865. A private carrier is not governed by this act. His position is that of a bailee.

Gratuitous Carrier. A gratuitous carrier is one who carries goods (or passengers) without any charge. The owner of a motor car who gives a lift to a friend is a gratuitous carrier.

¹ (1918) 1 K.B. 210

CHAPTER 2

CARRIAGE BY LAND

DUTIES OF A COMMON CARRIER

The duties of a common carrier in India are determined by the Common Carriers Act and (as regards points not covered by this Act) by the rules of English law. The duties can be summed up as follows :

1. A common carrier is bound to carry the goods of every person, without any distinction. But certain exceptions are recognised. A common carrier can refuse to carry under the following circumstances :

- (a) if the customer is not willing to pay reasonable charges for the carriage ;
- (b) if there is no accommodation in the carriage ;
- (c) if the goods are dangerous or are of a type which the carrier is not accustomed to carry ; and
- (d) if the goods are to be carried over a route with which the carrier is not familiar. (A carrier is entitled to confine himself to the carriage of a particular type of goods and/or over a particular route. In such cases the carrier can refuse to carry goods over unaccustomed routes and to carry goods which he does not usually carry).

If a carrier, without any of the reasons mentioned above, refuses to carry the goods of a person, he can be sued and the customer can recover damages. *G. W. Rly. Co. v. Sutton*.¹

2. The Carrier must deliver the goods at the agreed time or (if no time had been agreed upon) within a reasonable time. The place of delivery is subject to contract.

3. The goods must be carried with reasonable precautions for their safety and over the usual and ordinary route. Deviations are not permitted unless rendered necessary by exceptional circumstances.

RIGHTS OF A COMMON CARRIER

1. A common carrier is not bound to carry goods under certain circumstances, e.g. when he has no room, when the goods are danger-

¹ (1869) 4 H.L. 226

ous or not of a type he is accustomed to carry, or when he is asked to carry goods to a destination to which he does not ordinarily travel.

2. He is entitled to reasonable charges for his work. He can allow concession rates to some customers but cannot demand unreasonably high payments from anybody. What is reasonable depends on the circumstances of the case.

3. He has a lien on the goods for his remuneration and can refuse to deliver the goods until his dues are paid. This is known as the Carrier's Lien.

4. If the consignee refuses to accept delivery of the goods, the carrier is at liberty to take such steps as are reasonable and prudent under the circumstances. He can recover all reasonable expenses incurred by him in this connection from the party with whom the contract of carriage was entered into.

5. The carrier is entitled to recover damages from the consignor if the goods given for carriage are dangerous or are loosely packed and the carrier suffers injury therefrom. *Bamfield v. Goole & Sheffield Transport Co.*²

6. The carrier can, subject to the provisions of the Carriers Act, enter into special contracts exempting him from liability under stated circumstances.

THE LIABILITIES OF A COMMON CARRIER

English Law. According to English Common Law a common carrier of goods is an Insurer, *i.e.* he is bound to indemnify the owner in full for any loss or damage to the goods in course of carriage. This rule of full liability is subject to certain exceptions. The carrier is not liable in the following cases:

(a) When damage is caused by an Act of God, by which is meant a natural calamity like a storm or earthquake.

(b) When damage is caused by the enemies of the State, *e.g.* during wars.

(c) When damage is caused by some inherent defect in the goods or negligence of the consignor.

(d) When there is a special agreement limiting the liability of the carrier.

(e) There is no liability for damages caused after the goods arrive at their destination.

² (1922) 2 K.B. 742

Indian Law. The liabilities of a common carrier of goods in India are laid down in the Common Carriers Act of 1865. This act divides goods into two categories: Scheduled and Non-scheduled. Scheduled goods are certain articles enumerated in a schedule to the Act. They are valuable articles like gold, silver, jewellery, paintings, silk, title deeds, currency notes and coins, etc. All other articles are non-scheduled.

For Scheduled articles exceeding Rs. 100 in value, the carrier is liable for all loss and damage,

- (a) if the value and the description of the goods are disclosed by the consignor to the carrier, or
- (b) if the loss or damage is due to a criminal act of the carrier, his agent or servant.

The common carrier can charge extra for carrying scheduled articles but cannot limit his statutory liability by any special agreement.

As regards non-scheduled articles, a common carrier can limit his liability by special agreements with the consignor. But he is responsible for loss or damage caused by negligence or criminal acts done by himself, his agents or servants.

In case of loss or damage, the claimant must notify the carrier within six months of the date of knowledge of the loss or damage.

The above rules apply only to common carriers as defined by the Common Carriers Act of 1865. Thus, they do not apply to railways and to carriers of passengers.

CARRIERS OF PASSENGERS

A carrier of passengers may be a common carrier or a private carrier or a gratuitous carrier. A common carrier of passengers is one who is ready and willing to accept anybody as a passenger *e.g.* a bus, a train or a taxi. A private carrier of passengers is one who occasionally carries passengers for hire. A gratuitous carrier of passengers is one who takes a passenger without charge.

Carriers of passengers are not subject to the Common Carriers Act of 1865. Some rules concerning such carriers are to be found in local statutes like the Motor Vehicles Acts and the Police Acts.

In the absence of any Indian statute dealing with the matter, the general principles concerning carriage of passengers must be deduced

from the English common law. The important rules regarding carriage of passengers are given below.

A common carrier of passengers is bound to carry any member of the public who is desirous of being carried, except in the following cases :

- (a) When the passengers is not willing to pay the stated fare.
- (b) When the passenger is unfit, *i.e.* suffering from some disease or infirmity.
- (c) When there is no accommodation.

The common carrier of passengers is not an Insurer. He must, however, take due care and exercise due diligence. He is liable for injuries caused by negligence to paid passengers and also to passengers travelling free with his knowledge and consent. But a passenger who, without the consent of the carrier is travelling without payment, is a trespasser and is not entitled to damages even though caused by negligence. A passenger injured by negligence is not entitled to damages if he is himself guilty of negligence. This is known as the principle of contributory negligence.

The common carrier of passengers can limit his liabilities by contract with his passenger.

Private and gratuitous carriers of passengers are not bound to accept any person as passenger. They can choose which passenger to carry. They are liable for loss or damage to the passenger in case of negligence.

DUTIES AND LIABILITIES OF RAILWAYS

The duties and liabilities of the railway administration in India are laid down in the Indian Railways Act of 1890, as amended up to date.

Duties. Under the Railways Act, the railway administration has certain statutory duties. These duties are similar to the duties of a common carrier as provided under the Common Carriers Act of 1865 and the rules of English common law. Section 42A of the Railways Act provides as follows :

“A railway administration shall not make or give any undue or unreasonable preference or advantage to, or in favour of, any particular person or railway administration, or any particular description of traffic, in any respect whatsoever, or subject any particular person or railway administration or any particular description of traffic to any

undue or unreasonable prejudice or disadvantage in any respect whatsoever."

The railway administration is bound (like a common carrier) to carry goods of every person provided the necessary freight is paid and the regulations concerning packing etc. are observed. The railway administration is also bound to carry every passenger who pays the necessary fare. It cannot discriminate between different passengers on any ground. It can therefore be said that the railway administration is a common carrier, so far as its duties are concerned.

Liabilities. As regards liabilities, the position of the railway administration is quite different from that of a common carrier and it cannot be called a common carrier. The Railways Act lays down the following rules concerning the liabilities of the railway administration for damages to, and loss of goods, and for injuries to passengers.

1. Sec. 72—The responsibility of the railway administration for loss, destruction or deterioration of goods is that of a bailee, as laid down in the Indian Contract Act. Therefore it is liable to pay damages in the following cases only—

- (a) when it arises from neglect to take such reasonable care as would have been taken by a man of ordinary prudence. (Sections 151 and 152, Contract Act) and,
- (b) when it arises after the proper time of delivery (Sec. 161, Contract Act).

2. Sec. 72A—Every consignor of goods or animals must execute a Forwarding Note in the form prescribed by the railway administration and approved by the Central Government. Four types of forwarding notes are in general use. Each type covers a particular kind of goods. Each forwarding note contains (a) particulars of the goods carried and (b) the terms of carriage, including a statement of the extent of liability of the railway for loss or damage. The railway administration is not responsible for loss or damage beyond what is provided for in the forwarding note. Thus the railway's liability as a bailee is further limited by the special terms contained in the forwarding notes. (Formerly, goods used to be carried under Risk Notes; now the Risk Notes have been substituted by Forwarding Notes).

3. Sec. 73—In the case of animals, the railway administration is not liable for loss or damage beyond certain amounts mentioned in the Act. They are as follows: elephants—Rs. 1500 per head; horses—Rs. 750 per head; mules, horned cattle, and camels—Rs. 200 per head; and in all other cases—Rs. 30 per head. The railway may

accept a higher liability if the animal is specially valuable. In such cases the value of the animal must be mentioned in the forwarding note and a higher freight must be paid. The railway is in no case responsible if the loss or damage is due to any action of the animal itself.

4. Sec. 74—*Passengers' luggage*: The railway is not responsible for any passenger's personal luggage, unless it is booked and handed over to the railway for carriage in the luggage van. The railways allow a certain quantity of luggage to every passenger without charge.

5. Sec. 74A—When the goods are in a defective condition or are defectively packed and the fact is noted in the forwarding note, the railway administration is not responsible for loss or damage except upon proof of negligence or misconduct on its part or on the part of its servants.

6. Sec. 74B.—When goods which, under ordinary circumstances, would be carried in closed trucks are at the request of the sender carried in open trucks, the railway administration is not responsible for damages that may arise from such carriage in open trucks.

7. Sec. 74C—Goods may be carried, if the sender so requests, at what is called owner's risk rates. The rates are low and the railway administration is not responsible for any loss except in cases of negligence and misconduct by the railway or its servants. When goods are sent at owner's risk rates, a particular form of Forwarding Note is used. If goods carried at owner's risk rates are damaged, the railway administration is bound to disclose how the consignment was dealt with during carriage. Where, from the disclosure made, it cannot fairly be inferred that there was negligence or misconduct the burden of proof that there was negligence or misconduct is upon the consignor.

8. Sec. 75.—When the parcel or package delivered for carriage contains goods of the kind mentioned in a schedule to the Act, the consignor is required (if the value of the goods exceeds Rs. 100) to disclose the value and contents of the parcel or package. (The goods mentioned in the schedule are valuable goods like gold, silver, silk, coins and notes etc.) The railway can demand additional freight for such consignments. When such additional freight is paid and the requisite declaration is made, the railway is liable to make good any loss or damage to the articles. If no declaration is made, the railway is not responsible. The railway officials may examine the contents of the package to be sure of the description and valuation.

9. *Injury to passengers*—Railways are not common carriers of passengers and are liable to pay damages for injury to passengers only

when it is due to the negligence of the railway's servants. By an amendment to the Railways Act in 1943 it was provided that the railway's liability for the death of a passenger would not exceed Rs. 10,000 per head. There is no liability if the passenger is guilty of contributory negligence.

Rights of Railways. The Act gives certain privileges to the railway administration. Bye-laws may be framed regarding the mode of carriage of goods and passengers. No person is allowed to carry dangerous or offensive goods. Violation of the provisions of the Railways Act and of the bye-laws are punishable by the court (*e.g.* travelling without tickets, carrying dangerous goods etc.). The railway possesses a lien on the goods carried, for freight and other charges, if any. In case of damage to goods no suit for compensation can be filed without submitting a previous notice in writing within 6 months of the date of delivery.

EXERCISES

1. Who are common carriers? What are their liabilities? (C.U. '59)
2. What are the respective rights, duties and liabilities of Common carriers and Private carriers? (C.U. '61)
3. How does the liability of the railway administration in India differ from that of other carriers? (C.U. '47, '48, '55; C.A., Nov. '51)

CARRIAGE BY SEA

THE CONTRACT OF AFFREIGHTMENT

The contract to carry goods by sea is called the Contract of Affreightment. The consignor (or his agent) and the shipowner (or his agent), are the two parties to the contract. The consideration paid for the carriage is called the Freight.

The contract of affreightment may be incorporated in a formal document containing all the terms of the agreement between the parties. Such a document is called a Charter-party. Sometimes, there is no formal document; the shipowner merely gives a receipt for the goods and in the receipt (known as the Bill of Lading) some of the terms of the contract are written down.

Carriage of goods by sea from any port in India to any other port, in or outside India, is governed by the Carriage of Goods by Sea Act of 1925. This act is based upon the recommendations of the International Conference on Maritime Law held in Brussels in 1922. The conference drew up a draft convention for adoption by the leading maritime nations of the world. The object was to secure uniformity of laws as regards the rights and liabilities of carriers by sea and the rules regarding bills of lading.

121 CHARTER-PARTY

The system of drawing up a formal document or Charter-party for the purpose of recording the terms of the contract of affreightment, developed by custom and is now the practice whenever the whole of a ship or a substantial part of it is hired for the carriage of goods.

A Charter-party may be defined as an agreement in writing for the purpose of hiring an entire ship or a part thereof for the purpose of carriage of goods.

The person hiring the ship or a part of it is called the Charterer. The terms of the Charter-party may amount to a lease or demise of the whole ship to the charterer for a stated period. In this case, the charterer becomes for the time being the owner of the vessel and the captain and the crew become his servants during the charter period.

3. The ship shall complete the voyage in the usual and customary manner and without any unnecessary deviation from the usual route.

The Carriage of Goods by Sea Act of 1925 lays down the following rules regarding the liabilities of a carrier of goods by sea from an Indian port :

1. The carrier shall be bound, before and at the beginning of the voyage, to exercise due diligence to,

(a) make the ship seaworthy ;

(b) properly man, equip and supply the ship ;

(c) make the holds, refrigerating and cool chambers, and all other parts of the ship in which goods are carried, fit and safe for their reception, carriage and preservation.

2. The carrier shall properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried.

3. After receiving the goods in his charge, the carrier or the master or agent of the carrier shall, on demand of the shipper, issue to the shipper a bill of lading containing the prescribed particulars.

4. Any clause in the contract of affreightment by which the carrier is relieved from the liability to pay compensation for loss or damage arising from negligence, fault or failure to perform the duties prescribed by the Act, is void and inoperative.

5. The shipowner is not liable for damage arising from unseaworthiness of the ship unless such damages are due to a failure to perform the duties mentioned in para 1 above. Thus in India the liability to keep the ship seaworthy is not absolute. Whenever damage is caused by unseaworthiness, the burden of proving the exercise of due diligence is on the shipowner.

6. The carrier is not responsible for loss or damage arising from the following causes: neglect or default of the servants of the carrier in the navigation and management of the ship; fire, unless caused by the fault or privity of the carrier; perils, dangers and accidents of the sea or other navigable waters; act of God; act of war; act of public enemies; arrest or restraint of princes, rulers or people or seizure under legal process; quarantine restrictions; act or omission of the shipper or his agents; strikes or lockouts; riots or civil commotions; saving or attempting to save life or property at sea; inherent defect in the goods; insufficiency in packing; insufficiency or inadequacy in marking; latent defects in the goods not discoverable by due

diligence ; any other cause arising without the actual fault or privity of the carrier.

7. The carrier is not responsible for any loss or damage to goods exceeding £100 or its equivalent unless the nature and value of such goods have been declared by the shipper and inserted in the bill of lading.

8. A carrier is at liberty to surrender in whole or in part all or any of his rights and to increase his responsibilities and liabilities, provided such surrender or increase is embodied in the bill of lading issued to the shipper.

9. The carrier and the ship shall be discharged from all liability for loss or damage unless suit is brought within one year of the delivery of the goods or the date when the goods should have been delivered.

THE SHIPOWNER'S LIEN

As a carrier, the shipowner has a lien on the goods carried for the freight and other charges. The lien can be enforced by not parting with the goods until his dues are paid. There is no lien when the freight has been paid in advance or when freight has been agreed to be paid after delivery of the goods.

MARITIME LIEN

A maritime lien is a right which specifically binds a ship, including its machinery, furniture, cargo and freight, for the payment of a claim based upon maritime law. Maritime lien is possessed by the following persons : seamen for their wages ; the holder of a bottomry bond for his dues ; claimants for damages in cases of collision with the ship concerned ; persons who rescue ships or property from the sea.

A maritime lien is not a possessory lien *i.e.* it can be exercised even without possession by filing a suit in the appropriate court. In cases of maritime lien the rule is that the *last* in time ranks *first* in payment.

CERTAIN TERMS USED IN CONNECTION WITH CARRIAGE BY SEA

Mate's Receipt. When goods are delivered to a ship for carriage, a receipt for it is sometimes given by the Mate, who is an officer of

the ship under the captain. The Mate's receipt can be subsequently exchanged for a regular bill of lading.

✓ **Clean Bill of Lading.** When it is stated in the bill of lading that the goods are in good order and condition, the bill is said to be a Clean Bill of Lading. When a clean bill of lading has been issued, the shipowner is estopped from claiming later on that the goods were in a bad condition.

Through Bill of Lading. Sometimes goods have to be carried partly by sea and partly by land. A bill of lading which covers both carriages is called a Through Bill of Lading.

Deviation. Deviation means departure from the usual and customary route or the route agreed upon in a charter-party. Deviation is permitted to avoid the perils of the sea. Under Indian law deviation is permitted for the purpose of saving life and property. Damages can be claimed for unnecessary or unauthorised deviation. Charter-parties usually contain a clause regarding deviation.

✓ **Perils of the Sea.** This term includes the dangers (apart from the ordinary actions of the wind and waves) which have to be faced in course of a sea voyage. *Examples* : storms ; collision with a sunken rock or an iceberg ; entry of water through a hole made by rats or a swordfish etc. A shipowner is generally exempted from liability when damages are caused by Perils of the Sea.

✓ **Excepted Perils.** A charter-party usually specifies the circumstances under which the shipowner is not liable for loss of, or damage to goods. These circumstances are known as the Excepted Perils. *Examples* : acts of God ; action of the enemies of the state ; perils of the sea, etc.

Barratry. Barratry means wilful acts of damages done by the crew in course of a mutiny or fight with the captain and the shipowner or among themselves.

Jettison. To jettison means to throw out. Goods may be jettisoned during a voyage in order to avoid the danger of the ship sinking or heeling during storms. Goods may also be jettisoned if they are dangerous.

✓ **Salvage.** When some persons save a ship or any of its appliances or cargo from shipwreck, capture (by enemies or pirates) or loss from any other cause, they become entitled to a reward. The reward is called Salvage. The Salvors, *i.e.* the persons saving the property, have a maritime lien on the ship, cargo and freight for the reward. The

amount of salvage is generally determined by the courts, but the parties may settle the amount among themselves.

Freight. Freight means the consideration paid by the shipper to the carrier for the carriage of goods. Freight is payable only if the goods are delivered in accordance with the terms of the contract. When the goods are lost the carrier is not entitled to recover the freight, even though the loss might have occurred under circumstances which exempt the carrier from liability for the loss. But delivery of the goods in a damaged condition does not prevent recovery of the freight, unless the damage is so great that the nature of the goods is completely altered.

By agreement the freight may be payable in advance. Advance Freight can be retained by the carrier if the goods are lost by an excepted peril.

When a charterer agrees to pay a lump sum for the use of a ship, irrespective of the amount of cargo loaded, it is called a Lump Sum Freight.

The shipper and the carrier may agree that if the cargo is delivered at a place other than the place agreed upon, the amount of freight will be changed in proportion to the distance actually covered. Such a freight is called a Pro Rata Freight.

If a shipper fails to load the amount of cargo he promised, he is liable to pay damages to the shipowner for the unfilled space. This is known as Dead Freight.

Formerly shippers had to pay some amount, in excess of the regular freight, to the crew of the ship by way of a tip. This is known as the *Primage*.

Freight is ordinarily payable by the person with whom the shipowner has entered into the contract of affreightment. But by agreement, freight may be payable by some other person, e.g. the consignee.

Lay Days. The term "lay days" means the days allowed for loading or unloading a ship. The number of days to be allowed as lay days is fixed by agreement and is usually mentioned in the charter-party where there is one. Where there is no agreement as regards lay days, a reasonable time is given for the purpose. Lay days begin from the time when the ship arrives at the place agreed upon and the shipper has notice of it.

Demurrage. If the loading or unloading is not completed within the lay days agreed upon, the carrier is entitled to damages. Such damages are called Demurrage. Demurrage is usually calculated

upon the number of days the ship is detained beyond the agreed lay days or reasonable time. Railways in India charge demurrage if goods are not loaded or unloaded within the time mentioned in the Railway Receipt.

Bottomry and Respondentia Bonds. The shipowner or the captain of a ship may find it necessary to borrow money on the security of the ship or the cargo or the freight. A bond by which the *cargo only* is pledged for the repayment of the money, is called Respondentia. A bond by which the *ship and the freight* are pledged is called a Bottomry Bond. (The term 'bottomry' comes from the word 'bottom', which means the keel of the ship and therefore stands for the whole ship.) The moneys due on a Bottomry or Respondentia Bond are payable only if the ship reaches its destination safely. The rate of interest is therefore very high generally. If there are more than one Bottomry Bonds, the later bondholders get priority over the earlier bondholders.

Particular Average Loss and General Average Loss. Goods may be lost in course of a voyage (thrown overboard or destroyed) by accident or by deliberate intent. In some cases the loss has to be borne by the owner of the goods lost. In some cases the loss of the owner has to be made up by contributions from the owners of the remaining cargo. The first type of loss is called a Particular Average Loss. The second type of loss is called a General Average Loss.

Cases of particular average loss: When a particular article is lost by accident, the owner must bear the loss. For example, if a boat belonging to the ship is lost during a storm the loss falls on the shipowner and he cannot claim contribution from the cargo-owners. Similarly if an article is thrown overboard because it is dangerous, the loss must be borne by the owner. These are cases of particular average loss.

Cases of General Average Loss: When goods are thrown overboard or destroyed in order to save the ship or protect the adventure undertaken, it is called a general average loss. *Example:* goods thrown overboard in order to make a ship lighter during a storm so that it will not sink. The loss of the owner of the goods in all such cases must be compensated by contributions from the other cargo-owners. The following conditions must be satisfied before a general average contribution can be claimed:

(1) There must have been a common danger. The danger must be real and not an imagined danger.

(2) The danger must not have been due to a fault of the goods destroyed. A horse which turns mad in course of the voyage is a

common danger but if it is destroyed, its owner cannot claim contribution.

(3) The sacrifice of the property concerned was voluntary and reasonable.

(4) Owners of cargoes which are not saved, cannot be called upon to contribute.

The fixation of the amount to be contributed by each cargo-owner is a complicated process. It is done by experts known as Average Adjusters. It is usually provided in the contract of affreightment that the adjustment of general average loss will be done according to a set of rules known as the York-Antwerp rules. These rules were drawn up in international conferences held in York, Antwerp and certain other places. If the contract of affreightment does not contain any such provision, the adjustment is done according to the law of the country where the adjustment is made.

EXERCISES

1. Write notes on: General Average Loss (C.U. '60); Particular Average Loss; Respondentia and Bottomry Bonds; Excepted Perils.
2. What is a Charter Party? Mention the usual terms in a Charter Party (C.U. '60)
3. Write notes on Charter Party. (C U. B Com. '62)

CHAPTER 4

CARRIAGE BY AIR

The law relating to carriage by air in India is contained in the Carriage by Air Act of 1934. This act is based upon a draft convention drawn up in the international conference held in Warsaw in 1929. The provisions of the Act are stated below.

THE DOCUMENTS OF CARRIAGE

The Act of 1934 provides that certain documents are to be issued when goods and passengers are carried by air. They are as follows :

The Passenger Ticket. Whenever a passenger is carried, he must be given a ticket and the ticket must contain the following particulars : the place and date of issue ; the names of the places of departure and destination ; the agreed stopping places ; the name and address of the carriers ; and a statement that the carriage is subject to the provisions of the Act of 1934.

The Luggage Ticket. For all luggages other than personal goods in charge of the passenger, a luggage ticket must be issued. The luggage ticket must contain all the particulars necessary to be included in a passenger ticket and in addition must mention, the number and weight of the packages and a statement that the luggage shall be delivered to the holder of the luggage ticket.

The Air Consignment Note. Whenever goods are carried, the carrier can insist upon the consignor making out three copies of an Air Consignment Note containing the following particulars : the place and date of its issue ; the places of departure, destination and stoppages ; the names and addresses of the carriers ; the names and addresses of the consignor and the consignee ; the nature of the goods, including a statement of the number of packages, the method of packing, their weight, quantity, volume and dimensions and the apparent condition of the goods ; the amount of the freight and the persons liable to pay it ; the period of the carriage and the route ; and, a statement that the carriage is subject to the rules contained in the Act.

The Air Consignment Note is to be issued in triplicate. One copy is to be kept by the carrier ; one copy, signed by both the carrier and the consignor is to accompany the goods ; and the third copy is

to be kept by the consignor. The consignor is responsible for the correctness of the particulars in the Note and is liable to pay all damages, if any, arising from incorrect statements.

If any of the documents mentioned above, *viz.* the passenger ticket, the luggage ticket, and the air consignment note, is not issued the carrier is deprived of the provisions of the Act by which his liability for loss or damage is limited. But the contract of carriage (of goods or passengers, as the case may be) is valid even if no document is issued.

RIGHTS AND DUTIES OF THE CONSIGNOR

The consignor may withdraw the goods from the custody of the carrier at the place of departure or destination or at any intermediate station. He may change the name of the consignee. He cannot however exercise any of these rights in such a way as to prejudice the interests of the carrier. The consignor must also pay all necessary expenses.

RIGHTS AND DUTIES OF THE CONSIGNEE

The consignee is entitled to take delivery of the goods at the place of destination. If the goods are lost or do not arrive at the place of destination within seven days of the date of delivery, he can enforce his rights under the contract of carriage.

LIABILITIES OF THE CARRIER BY AIR

★ The carrier by air is, subject to certain rules mentioned below, liable to pay damages in the following cases :

1. Death or bodily injury suffered by a passenger, if the accident which caused the injury occurred during carriage or during embarking or disembarking.
2. Destruction or loss of, or damage to, any registered luggage or any goods during the time they are in charge of the carrier, on the plane, in the aerodrome or elsewhere.
3. Delay in the carriage of passengers, luggage or goods.

Rules limiting the liability of the carrier : The carrier is not liable to pay any damages in the following cases :

1. If he proves that he and his agents have taken all necessary measures to avoid the damage or that it was impossible for him or them to take such measures.

2. If he proves that the damage was occasioned by negligent pilotage or negligence in the handling of the aircraft or in navigation and that, in all other respects, he and his agents have taken all necessary measures to avoid the damage.

3. If he proves that there was contributory negligence on the part of the injured persons. (In this case the court may exonerate the carrier from liability either wholly or partially.)

The damages payable by the carrier is limited to the following amounts :

1. In the case of passengers—1,25,000 francs per head.
2. For luggage and goods—250 francs per kilogram.
3. Goods in charge of the passenger—5000 francs per passenger.

(Franc means the pre-war franc equivalent to 65.5 milligrams of gold.)

The carrier may, by a special agreement, accept liability for amounts *exceeding* those mentioned above. But any agreement purporting to *reduce* his liability is null and void.

The carrier is not entitled to avail himself of the rules limiting or excluding his liability if the damage is caused by the wilful misconduct of himself or his agents. The court is to decide whether any act amount to wilful misconduct.

THE PROCEDURE FOR REALISING DAMAGES

The person entitled to damages must complain to the carrier within 3 days of the date of delivery in case of loss of or damage to luggage, 7 days in a similar case regarding goods, and 14 days in cases where damages are claimed for delay in transit.

Suits may be filed in the court having jurisdiction over the place of destination or over the place of business or residence of the carrier. In case of the death of a passenger, the suit for compensation may be filed by his legal representative.

Suits must be filed within two years of the date of arrival of the carrier at the place of destination or the date on which it should have arrived or the date on which the carriage stopped.

When there are successive carriages in different air lines covered by the same documents of carriage :

- (a) actions for damages to passengers are to be brought against the carrier at the time of the accident, unless otherwise agreed ; and

(b) in actions for damage to luggage and goods, the consignor is to sue the first carrier ; the consignee, the last carrier ; but passengers may sue all the carriers.

EXERCISES

1. Explain what is meant by an Air Consignment Note. What is the consequence of such a note not being issued ?
2. State how far a carrier by air is liable for death or bodily injury to a passenger and for loss or damage to goods.

BOOK VIII

THE LAW OF INSURANCE

CHAPTER 1

THE GENERAL PRINCIPLES OF INSURANCE

DEFINITION OF INSURANCE

Insurance is a method of eliminating or reducing risk. By insurance a person can protect himself (and his dependants) from loss arising from future uncertain events like fire, accident or premature death.

Examples of insurance contracts :

- (i) A house can be insured against fire. The owner pays an agreed amount periodically to the insurer and the latter undertakes to make up any loss that may occur by fire during the subsistence of the agreement.
- (ii) Ships and goods sent by ships can be insured against loss during a voyage.
- (iii) A person may insure his life against premature death. He pays an agreed amount of money periodically and the insurer promises to pay a lump sum upon his death. A provision is thereby made for the dependants of the person.
- (iv) A singer may insure against accidents to his voice.

Insurance converts an uncertain risk into a certain and ascertained sum of money. A ship going out to sea may or may not be lost. If it is uninsured and is lost, the entire loss will fall on the owner. If it is insured and is lost, the owner will recover the value of the ship from the insurer but he has to pay to the insurer a certain sum of money called the premium. In case the ship is not lost the premium paid is a 'loss'. But this loss is small as compared to the loss that will be incurred if the ship is sunk. The premium is considerably less than the value of the ship which is insured. Thus by insurance a person exchanges an uncertain heavy loss for a certain small loss. This is the general principle on which insurance contracts are based.

As regards the insurer, he can undertake the risk for a small premium because all the ships going out to sea are not lost. The

insurer knows that he will not have to pay *all* shipowners who insure their ships. There are statistical methods of calculating what percentage of ships will be lost. The insurer fixes the amount of premium on the basis of these calculations. Therefore in the long run he makes a profit on the risks that he undertakes. Thus insurance is advantageous to the insurer and also to the insured.

The great advantages of insurance have led in recent times to an enormous expansion of the volume of insurance business and the evolution of many different types of insurance.

THE CONTRACT OF INSURANCE

A Contract of Insurance is a Contract between two parties whereby one party (called the Insurer) agrees to pay to the other party a certain sum of money on the happening of a specified contingency, or agrees to indemnify the other party from losses arising from certain specified events. The other party to the contract (called the Insured) pays an agreed sum of money (called the Premium) as consideration.

A contract of insurance must fulfil all the essential requirements of a contract as laid down in the law of contract. Thus, there must be a proposal and acceptance, the parties must be capable of contracting, the object must not be illegal or immoral etc.

It was held in *Hindusthan Co-operative Insurance Society v. Shyamsundar*,¹ that the contract of insurance is formed as soon as the insurance company accepts the premium or in any other way shows that the proposal to insure has been accepted.

The characteristics of a Contract of Insurance are enumerated below :

1. A contract of insurance is a contract *uberrimae fidei* (i.e., one based on good faith). It is the duty of the insured person to disclose all material facts concerning the subject matter of the insurance. If a material fact is not disclosed, or if there is misrepresentation or fraud, the insurer can avoid the contract. What is a material fact, depends on the circumstances of the case. Generally speaking, a material fact is one which affects the nature or incidence of the risk. Any fact which the insurer will take into account when considering whether to accept the risk or not and any fact which has a bearing on the amount of premium which the insurer will charge, must be con-

sidered a material fact to be disclosed. Thus, an applicant for a fire insurance policy must disclose all facts regarding the susceptibility of the property (to be insured) as regards fire.

The insured or assured must disclose all facts which a *reasonable man* would regard as material. *Joel v. Law Union Insurance Co.*²

The disclosure of facts must be substantially accurate. Misleading statements amount to a breach of duty. But unimportant misstatements or omissions may be excused. *Dawson's Ltd. v. Bonnin*.³

The duty of disclosure exists at the time when the contract of insurance is entered into. Material facts coming to the knowledge of the insured subsequent to the contract need not be disclosed.

Example

The applicant for an insurance policy was asked whether he had applied to any other company for insurance and whether such application has been accepted. He answered that he was insured with two companies but failed to disclose that his application was rejected by several other companies. It was held that there was material concealment and the policy was set aside. *London Assurance Co v. Mansell*⁴

Section 45 of the Insurance Act provides that no policy of life insurance can be called into question by the insurer two years after the date it was effected on the ground of misstatement unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policy-holder and that the policy-holder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose.

2. Life insurance is a *contingent contract*. The money is payable on the happening of a contingency (*viz.* death) the date of which is uncertain.

Other forms of insurance (*e.g.* fire or marine) are *contracts of indemnity*. The insurer in these cases promises to indemnify the insured person against the consequences of fire, accident or some mischance and misfortune. "The contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified but shall never be more than fully indemnified." *Castellain v. Preston*.⁵

² (1908) 2 K. B. 863

³ (1922) A. C. 413

⁴ (1879) 11 Ch. D. 363

⁵ (1883) 11 Q.B.D. 390

Suppose that a house is insured against fire for Rs. 20,000. It is burnt down but it is found that Rs. 15,000 will restore it to its original condition. The insurer is liable to pay only Rs. 15,000, unless otherwise agreed under the contract of insurance.

But if the contract of insurance provides for the payment of a *fixed* sum of money on the happening of an event (like fire, accident or burglary) the contract is not one of indemnity. Thus a fire, marine or accident insurance may, in particular cases, be a contingent contract.

In the case of life insurance, the insurer is liable to pay whatever sum is mentioned in the policy as being payable upon the contingency specified. Thus life insurance is always a contingent contract.

3. **Insurable Interest.** In every contract of insurance the policyholder must possess an Insurable Interest. Insurable interest means some proprietary or pecuniary interest. The object of insurance is to protect the insurable interest. If there is no insurable interest there can be no insurance. X cannot insure Y's house. But if Y's house is mortgaged to X, X has an interest to protect and he may insure the house. A man cannot insure the life of a stranger but he can insure the life of himself and of persons in whose life has a pecuniary interest. It has been held that for the purposes of life insurance, insurable interest exists in the following cases: husband in the life of his wife and wife in the life of her husband; parent in the life of the child if there is any pecuniary benefit derived from the life of the child; creditor in the life of the debtor; employer in the life of his employee; surety in the life of the principal debtor; etc.

In the case of life insurance, insurable interest must exist at the time when the insurance is effected. The policy remains good even if the insurable interest ceases to exist subsequently. The assignee of a life policy need have no insurable interest because when the policy was effected there was an insurable interest.

In the case of fire or marine insurance, the insurable interest must exist at the time when the claim is made. If this condition is satisfied the insurer must pay the claim even if the policyholder had no insurable interest at the time when the contract was entered into.

A contract of insurance entered into without any insurable interest is a wagering agreement and is void.

Persons, who have insurable interest in different types of properties, are enumerated below.

1. **Immovable properties**—owners; mortgagors and mortgagees; landlords and tenants; vendors and purchasers.

2. Movable properties—owners; pledgors and pledgees; bailors and bailees; carriers; all lien-holders.

3. A shareholder has an insurable interest in his share; an agent in his commission; a businessman in his stock-in-trade and in his profits.

4. Ships—In marine insurance contracts the following persons have insurable interest: owners; crew of the ship for their wages; owners of cargoes; holders of bottomry and respondentia bonds, etc.

EXPLANATION OF CERTAIN TERMS

Certain terms, used in connection with contracts of insurance are explained below.

Insurer. The party which promises to pay money to or indemnify the other party upon the occurrence of some specified event is called the Insurer. In marine insurance contracts the insurer is sometimes called the Underwriter. The Insurance Act of 1938 provides that the Insurer may be an individual or a firm or a company. To carry on the business of insurance in India it is necessary to be registered under the Act.

Insured or Assured. The person who under a contract of insurance will receive money or indemnity upon the occurrence of some specified event is called the insured person. In life insurance contracts the insured person is also called the Assured. (Since the contract of insurance is incorporated in a document called the Policy, the insured or the assured may also be called the Policy-holder. The term policy-holder includes an assignee from a policy-holder, where such assignment is absolute and indefeasible.

Insurance Policy. The terms of a contract of insurance are usually written down in a document known as the Insurance Policy. The Policy is stamped and signed by the insurer and handed over to the insured. The Policy is evidence of the fact of insurance. Except in cases of marine insurance, it is not legally compulsory to issue a policy. The terms of a contract of insurance (except a marine insurance) can be proved by oral evidence. It is however the general practice among insurance companies in India to issue a policy after a contract of insurance is entered into. The date of issue of the policy is not necessarily the date from which the risk is covered. The risk attaches from the time the contract of insurance is entered into i.e. the proposal is accepted. The policy may be issued later. The pro-

duction of the policy is not a condition precedent to the recovery of the money. The identity of the claimant and the fact of insurance may be proved by oral evidence.

Premium. The consideration payable by the insured person to the insurer is called the Premium. Usually the consideration is a sum of money but there is nothing in insurance law which prevents the acceptance of consideration in any other form. The premium may be a fixed amount or it may vary (increase or decrease) according to circumstances agreed upon. The time of payment depends upon agreement. Payments may be made monthly, quarterly or annually or by a single lump sum payment. The premium has to be paid by a fixed date but usually insurance companies allow a certain number of days of grace beyond the agreed date. For premia payable quarterly one month's extra time is usually given. Ordinarily a policy lapses if the premium due is not paid within the due time plus the grace period. But after a policy acquires a surrender value (see below) non-payment of premium does not involve lapse of the policy.

The amount of premium is determined by an actuarial calculation of the risk involved.

The Insurance Agent. Insurance agents are brokers or middlemen who bring about contact between the insurer and the insured. An insurance agent in India must be licensed according to the provisions of the Insurance Act of 1938. The Act also lays down rules regarding their remuneration.

Actuary. An Actuary is an expert employed by insurance companies to calculate and determine the risks involved in insurance. The Act of 1938 imposes certain duties on actuaries. To act as an actuary a person must be a member of the Institute of Actuaries, London or a Fellow of the Faculty of Actuaries, Scotland or possess such qualifications as are considered requisite by the Controller of Insurance.

TYPES OF INSURANCE

The three most important types of insurance are Life, Fire and Marine insurance. In addition to these three, there are various miscellaneous types of insurance, *e.g.* accident, motor vehicles, burglary, etc.

Formerly all types of insurance business used to be carried on by private insurers and companies. From January 1956, the insurance has been nationalised. The other forms of insurance are in private hands.

INSURANCE AND WAGER

A contract of insurance appears to be similar to a wagering contract. The policy money is payable on the happening of a future uncertain event. In the case of whole life insurance the date or occurrence of the event on which the money is payable, is uncertain. In the case of fire, marine and other forms of insurance the happening of the event upon which the money is payable, is itself uncertain. In an early case on insurance it was observed that, "Insurance is a contract on speculation." [Lord Mansfield in *Carter v. Boehn*.⁶] But the modern view is that insurance contracts are not speculative or wagering contracts. The points of distinction between a contract of insurance and a wagering contract are mainly the following :

1. In an insurance contract there always exists an insurable interest. In a wagering contract there is none.
2. In an insurance contract the object is to protect an interest. In a wagering contract the object is to gamble for money.
3. Wagering contracts are void because they are considered to be against public policy. Insurance contracts are considered to be in the public interest and are therefore valid.

OBLIGATIONS OF THE INSURER

The obligations of the insurer are determined by the terms of the contract of insurance. The most important obligation of the insurer is to pay the money due on the policy upon the happening of the contingency specified in it. The liability to pay is subject to the following conditions :

1. The insurer is liable to pay only if the contract of insurance fulfils all the essential elements of a valid contract. If there is non-disclosure of material facts or fraud the contract is voidable.
2. The risk of the insurer commences after the contract of insurance is entered into, *i.e.* after the proposal to insure is accepted. Mere submission of a proposal to the insurer is not enough. The insurance agent usually has no authority to accept a policy.
3. The insurer is liable only for those losses which directly and reasonably follow from the event insured against. The insurer is not liable for remote consequences and remote causes. This principle is expressed in the maxim, "*Causa proxima non remota spectatur*".

⁶ (1765) Sm. L.C. 546

Examples :

- (i) A ship was insured against losses resulting from collision. There was a collision and the ship was delayed for a few days. Owing to the delay a cargo of oranges in the ship became unfit for human consumption. Held, the insurer was not liable for the loss because the proximate cause of the loss was delay and not collision. *Pink v. Fleming*.⁷
- (ii) A ship was insured against damage by enemy action. It was injured by passing over a torpedoed ship. Held no damages were recoverable because the damages in this case were not due directly to enemy action but to the fact that a sunken vessel lay at a particular place. *William and Co. v. North of England etc. Ass.*⁸
- (iii) In the above case it was also held that when the enemy had purposely sunk a vessel at the entrance of a port with a view to damaging ships entering that port, any damage actually suffered by collision with such a vessel must be deemed to be directly due to enemy action and the insurer must pay compensation.

4. Under certain circumstances the insurer is bound to return the premia received, *e.g.* when the contract of insurance is set aside on the ground of fraud by the insurer. If an insurance policy becomes void on the ground of non-disclosure of material facts or fraud by the insured person, the premia are not returnable.

5. The Insurance Act of 1938 imposes certain obligations upon insurance companies in India regarding registration, licensing, organisation and the submission of returns and reports.

RIGHTS OF THE INSURER

The insurer has the following rights :

1. **The Payment of Premium.** The policy-holder must pay the premium according to the terms of the contract. Upon non-payment the policy lapses. In life insurance contracts, after the premia have been paid for three consecutive years, the policy acquires a surrender value and a certain proportion of the amount insured for is payable to the policy-holder.

2. **The Right to Contribution.** A particular property may be insured with two or more insurers against the same risk. In such cases the insurers must share the burden of payment in proportion to the amount assured by each. If any one of the insurers pays the whole loss, he is entitled to contribution from the other insurers.

⁷ (1899) 25 Q. B. D. 396

⁸ (1917) 2 K.B. 527

Example :

A house is insured against fire for Rs. 20,000 with X company and for Rs. 10,000 with Y company. A fire occurs and the damage is estimated at Rs. 6,000. X and Y share the loss in the proportion of 20,000 : 10,000, i.e. 2 : 1. X company will pay Rs. 4,000 and Y company will pay Rs. 2,000. The policy-holder can sue both the companies together or any one of them. Suppose that he sues X and recovers from him Rs. 6,000. X can claim contribution from Y to the extent of Rs. 2,000.

3. The Principle of Subrogation. Subrogation is a form of substitution. In marine and fire insurance contracts after the policy-holder is indemnified in full, the insurer becomes entitled to the remnants of the property insured and all rights and claims which the policy-holder may have against third parties. The insurer is subrogated to the position of the insured.

Examples :

- (i) P insured his house against fire with Q company. Subsequently he entered into a contract with R for the sale of the house. Before the sale could be completed the house was burnt and Q paid the full value of the house to P. P then obtained from R the value of the house as per the contract of sale with him. It was held by the court that P must refund to Q company the amount he obtained from them. *Sastellain v. Preston*.*
- (ii) A ship insured against total loss is sunk. The insurer pays the value in full. If the ship is subsequently salvaged, the insurer is entitled to the sale proceeds of the remnant if any. The same rule applies to goods.

The principle of subrogation is based upon equity. If the insurer pays the indemnity in full, he ought to get whatever remains of the damaged property. Also, the policy-holder ought not to get more than the value of the property because that will enable him to make a profit out of the insurance.

The principle of subrogation applies only on payment of the whole loss. In case of partial losses the principle does not apply. The principle also does not apply in cases where the contract of insurance is not a contract of indemnity.

DUTIES OF THE POLICY-HOLDERS

1. The policy-holder must disclose all material facts. The statement of facts made by him in the proposal form must be correct.

* (1883) 11 Q. B. D. 380

2. The policy-holder must pay the premium on the due dates.
3. In the case of fire, marine, burglary and other forms of insurance of property, the policy-holder must take reasonable measures for the protection of the property. The duties of the policy-holder in cases of such insurance are usually written down in the policy and form part of the terms and conditions of the contract of insurance.
4. Under Section 41 of the Insurance Act of 1938, the policy-holder is not allowed to receive any part of the commission payable on the policy or any rebate on the premium. If he accepts any such payment he may be punished with a fine which may extend to Rs. 500.

RIGHTS OF THE POLICY-HOLDERS

1. In case of life insurance, policy-holders or their heirs, nominees and assigns are entitled to receive the money stipulated for in the policy on the happening of the specified contingency. In the case of other forms of insurance, the policy-holder is entitled to be indemnified for all losses sustained from the peril insured against.
2. The policy-holder is entitled to assign the policy, whereupon the assignee becomes entitled to all the benefits of the policy. (See below, under Assignment).
3. After the lapse of two years from the date of the contract, an insurance policy cannot be questioned on the ground of any misstatement unless such misstatement was fraudulent.—Sec. 45, Insurance Act.
4. Under the Insurance Act of 1938, policy-holders are entitled to get the following documents : copies of all returns submitted by the insurer to the Controller of Insurance ; memo and articles of the insurance company ; copies of the proposal and the medical report ; notice regarding default of premium ; written acknowledgement from the insurer of transfer, assignment and nomination.
5. Subject to certain conditions, a life insurance policy does not lapse for non-payment of premium if premium was paid for three consecutive years.—Sec. 113.
6. At least one-fourth of the total number of directors in a life insurance company must be elected by the policy-holders. (This provision of the Act of 1938 is no longer effective, because life insurance has been nationalised and is now managed by the Government owned Life Insurance Corporation).

DOUBLE INSURANCE

When the same risk and the same subject-matter is insured with more than one insurer, there is said to be double insurance. *P*, the owner of a house, insures it against fire for Rs. 30,000 with *X* company and Rs. 10,000 with *Y* company. This is double insurance. The following rules apply in cases of double insurance :

1. A person is free to insure his property with any number of insurers. But in case of loss occurring he will not be allowed to recover more than the actual loss from all the insurers together. Thus if in the above example the actual value of the house is found to be Rs. 20,000, the insurers will pay, in case of total loss by fire, only Rs. 20,000. This amount will be shared between the insurers in proportion to the value of each insurer's policy. If any one of the several insurers pays the whole loss, he is entitled to contribution from the other insurers. The insured is never allowed to make a profit out of a fire or any other mischance.

2. In case of life insurance there may be any number of policies for any amounts. A man is entitled to place any value he likes upon his life and therefore upon death, all the policies are payable whatever the total amount may be.

REINSURANCE

Reinsurance means the transfer of a part of the risk by the insurer. Suppose that a ship has been insured for Rs. 10 lakhs. The insurer may feel that the risk is too heavy to be borne by him alone. If so, he can transfer a part of the risk to another insurer. The latter will then be entitled to get a proportionate part of the premium and will, in case of loss be liable to pay the portion of the risk transferred to him.

The reinsurer is liable only to the first insurer. There is no privity of contract between the reinsurer and the originally insured person. The terms and conditions of the original policy are usually applicable to the re-insurer. If for any reason the original policy lapses, the re-insurance comes to an end. The re-insurer is generally entitled to all the benefits of the original policy, *e.g.* that of subrogation.

ASSIGNMENT OF POLICIES

An insurance policy can be transferred by (i) an endorsement on the policy and (ii) by a deed of assignment. Notice must be given

to the insurer. The assignee is entitled to the benefit of the policy. It is not necessary that he should have an insurable interest (see below, under 'Life Insurance'). Consent of the insurer is not necessary for the validity of an assignment.

INSURANCE BUSINESS ON THE DIVIDING PRINCIPLE

An insurer is said to carry on business on the dividing principle if the policies issued by him provide,—

(i) that the benefit payable to any policy-holder will depend, wholly or partly, upon the number of claims becoming mature within certain time limits; or

(ii) that the premium payable by a policy-holder will depend, wholly or partly, upon the number and amount of claims becoming mature within a certain period of time.

Section 52 of the Insurance Act prohibits insurance business on the dividing principle in India.

EXERCISES

1. What do you understand by 'insurable interest' in connection with Life, Fire and Marine Insurance? When must it subsist in the case of each type? Enumerate the different kinds of insurable interest recognised by law. (C.U. '56)

2. In what cases and to what extent can a person effect an insurance on another's life? (C.A. May '51)

3. Explain what is meant by insurable interest with reference to life, fire and marine insurance. (C.A. Nov. '58)

4. (a) Distinguish between re-insurance and double insurance.

(b) Explain what is meant by a contract of insurance. (C.U. '57)

5. A contract of insurance is a contract uberrimae fidei. Explain. (C.U. '58)

6. Explain with illustrations: (a) Insurable interest (b) General Average Loss (c) Reinsurance. (C.U. '60)

7. Write notes on: Floating Policy; Double Insurance. (C.U. B.Com. '62)

CHAPTER 2

LIFE INSURANCE

DEFINITION

“Life insurance business” means the business of effecting contracts of insurance upon human life. It includes,

- (i) any contract whereby the payment of money is assured upon death (except death by accident only); or the happening of any contingency dependent on human life;
- (ii) any contract which is subject to the payment of premiums for a term dependent on human life;
- (iii) any contract which includes the granting of disability and double or triple indemnity accident benefits; the granting of annuities upon human life; and the granting of superannuation allowances.—Sec. 2(11), Insurance Act.

Difference between life insurance and other forms of insurance. Life insurance differs fundamentally from other forms of insurance. The points of difference can be summed up as follows :

1. Life insurance is a contract depending upon human life. Other forms of insurance relate to property.

2. In life insurance the liability of the insurer to pay the sum assured arises upon death of the person concerned or the attainment by him of a certain age. The event upon which the money is payable is certain to occur but the date of occurrence is uncertain. In other forms of insurance the peril insured against may or may not occur.

3. Life insurance is a contingent contract. The full amount mentioned in the policy must be paid on the happening of the contingency stipulated in the policy. Other forms of insurance are contracts of indemnity and the insurer is only liable to make good the actual loss suffered.

4. In life insurance there must be insurable interest at the time the contract of insurance is entered into. In other forms of insurance insurable interest must exist at the time the loss occurs.

5. Life insurance contracts are long term contracts. Fire, marine, accident and other forms of insurance are generally entered into for one year subject to renewal at the end of the year.

TYPES OF LIFE INSURANCE POLICIES

There are various types of life insurance. The principal types are described below.

The Whole Life Policy. A whole life policy is one under which a lump sum of money is payable upon the death of the assured to his heirs or nominees.

The Endowment Policy. An endowment policy is one under which a lump sum of money is payable to the assured upon his attaining a certain age, or in the event of his dying earlier, to his heirs or nominees upon his death.

The Joint Life Policy. A Joint Life Policy involves the insurance of two lives simultaneously. The policy money is payable upon the death of any one of the lives insured. If there is a joint life policy of *A* and *B*, the money is payable upon the death of either *A* or *B*. *A* and *B* may be husband and wife or partners in a firm. Partners very often enter into this form of insurance. The premium is paid by the firm and the money is payable to the firm. Upon the death of any partner the insurance money is used to buy out the heirs of the deceased partner and the firm goes on with the remaining partners. If there were no insurance the heirs of the deceased partner would have had to be paid out of the partnership assets and this might have led to the dissolution of the firm.

Annuities. An annuity policy is one under which the policy money is payable to the assured by monthly or annual instalments after he attains a certain age. The assured pays premium up to a certain age or (sometimes) a lump sum of money. The insurer pays a certain sum monthly or annually to the assured after he attains a certain age. The usual object of annuities is to provide for one's old age.

Limited Payment Policies. In some life policies the obligation to pay premium ceases after the assured attains a certain age. Such policies are called Limited Payment Policies.

Miscellaneous Types. Insurance Policies may be effected for the purpose of ensuring the education expenses of children or the marriage expenses of daughters. The insurer agrees to pay a certain sum for the purpose when the children attain a certain age. Premiums are payable by the person entering into the contract of insurance. If he dies before the maturity of the policy no further premiums are payable. Policies of this type ensure the education and marriage of children even in cases of premature death of parents.

SURRENDER VALUE

Prior to the passing of the Insurance Act of 1938 non-payment of premium at any time involved cancellation of the contract of insurance and forfeiture of the premia paid. As this involved considerable hardship, the Act of 1938 provides that a life insurance policy will not lapse for non-payment of premiums if the following conditions are fulfilled : (Sec. 113).

1. Premiums have been paid for at least three consecutive years. (In the case of policies issued by provident societies—for five consecutive years.)
2. The policy is one under which money is payable upon the happening of a contingency which is certain to happen.
3. The policy is for a sum of more than Rs. 100.
4. The parties have not, after default has occurred, agreed in writing to some other arrangement.
5. The policy does not contain a term which provides that the policy will be maintained in force, after default, out of the acquired surrender value.

After premiums have been paid for three consecutive years (or five in the case of provident societies) the policy acquires what is called a Surrender Value. The surrender value is obtained by multiplying the sum assured by a fraction. The premia actually paid is the numerator of the fraction and the premia payable is the denominator. Thus the surrender value bears to the sum assured the same proportion as the premia paid bears to the premia payable. Bonuses declared before default are to be added to the surrender value.

Example :

Suppose that X takes out an endowment policy for 15 years for Rs. 15,000 and the premium payable is Rs. 1,200 per annum. He pays premium for three years and then stops. The premium paid is $3 \times \text{Rs. } 1,200 = \text{Rs. } 3,600$. The premium payable is $15 \times \text{Rs. } 1,200 = \text{Rs. } 18,000$. The ratio between the two is $\text{Rs. } 3,600 \div \text{Rs. } 18,000 = 1/5$. The surrender value of the policy is $1/5 \times \text{Rs. } 15,000 = \text{Rs. } 3,000$. Bonuses, already accrued, are to be added to this figure.

If the conditions laid down for the acquisition of the surrender value are fulfilled the policy does not lapse and the insurer will pay, upon the happening of the contingency mentioned in the policy, to the assured or his heirs the surrender value of the policy.

ASSIGNMENT OF LIFE POLICIES

In an old English case, *Ashley v. Ashly*,¹ it was observed that life insurance policies are marketable commodities which can be validly assigned, with or without consideration, to persons who have no interest in the life insured. The principle, *viz.*, the assignability of life insurance policies, is accepted in modern times and permitted by law.

The Insurance Act of 1938 contains the following rules regarding assignment of life policies. (Sec. 38).

1. A transfer or assignment of a policy of life insurance, whether with or without consideration, may be made only by an endorsement upon the policy itself or by a separate instrument, signed in either case by the transferor or by the assignor or his duly authorised agent and attested by at least one witness, specifically setting forth the fact of transfer or assignment.

2. The transfer or assignment shall be binding upon the insurer after a notice in writing and endorsement on the instrument or a certified copy thereof is delivered to him.

3. In case of more than one assignment the priority of the claims of the assignees shall be governed by the order in which the notice to the insurer is delivered.

4. Upon the receipt of the notice, the insurer shall record the fact of transfer together with the date and the name of the assignee. The insurer is also bound to give a written acknowledgement of the receipt of the notice if the person giving the notice or the assignee demands such acknowledgement and pays a fee not exceeding Rupee one.

5. From the date of the notice the insurer shall recognise the assignee named in the notice as the only person entitled to benefit under the policy. The assignee can, if necessary sue without the consent of the assignor

6. Conditional assignments are valid. There may be an assignment in favour of a person subject to the condition that it shall be inoperative or that the interest shall pass to some other person on the happening of a specified event during the lifetime of the person whose life is insured. Similarly there may be an assignment in favour of the survivor or survivors of a number of persons.

¹ (1829) 3 Sim 149

NOMINATION BY THE POLICY-HOLDER

The holder of a policy of life insurance on his own life may, when effecting the policy or at any time before the policy matures for payment, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death. This is known as Nomination by the Policy-holder. The person named is called the Nominee. The Insurance Act contains the following rules regarding nomination: (Sec. 39).

1. The nomination may be incorporated in the text of the policy or be made by an endorsement on the policy. In the latter case the fact of nomination must be communicated to the insurer. A written acknowledgement of such communication shall be made by the insurer upon payment of a fee not exceeding Rupee one.

2. The insurer is discharged from his liabilities under the policy by paying to the recorded nominee. If the policy matures for payment during the lifetime of the insured or if the nominee or all the nominees die before the policy matures, the insurer shall pay the money to the policy-holder or his heirs or legal representatives or the holder of a succession certificate as the case may be.

3. A nomination can be cancelled or changed by a further endorsement on the policy or by a will. The insurer will be bound in such cases only after notice is given to him of the cancellation or change.

4. A transfer or assignment of a policy automatically cancels a nomination (except an assignment to the insurer to secure a loan).

Under English law, a nominee is entitled to receive the policy money only if he can show that a trust has been created in his favour by the policy-holder. *Cleaver v. Mutual Reserve Fund Life Association*.² The provisions of Section 39 of the Insurance Act of India are different.

The Difference between Nomination and Assignment. The assignment of a life policy involves the transfer of all the rights of the policy-holder to the assignee. The assignee becomes entitled to all the benefits of the policy and he can sue in his own name. Nomination does not involve the transfer of the policy-holder's rights. A nomination can be cancelled or changed. An assignment cannot be changed, although there can be a re-assignment in favour of the policy-holder by the assignee. Nomination is made to provide the insurer with a convenient method of discharging his obligations. The insurer can pay to the nominee without waiting for a succession certificate.

² (1892) 1 Q. B. 147

EFFECTS OF SUICIDE

A life insurance policy may contain a clause providing that no payment will be made in case the assured commits suicide. Such a clause is binding and where there is such a clause, the policy is avoided in case of suicide. The onus of proving suicide is upon the insurer.

Where there is no clause in the policy relating to suicide, it has been held in English cases that the policy becomes bad upon suicide and no money is payable. *Horn's case*.³ The contract of insurance is avoided even though the policy may have excepted suicide for a limited period only. *Beresford v. Royal Insurance Co.*⁴ The English decisions are based upon the fact that suicide by a person of sound understanding is regarded as self-murder, which is a felony under common law. A contract by which money is payable upon the commission of a felony is against public policy and is therefore bad in law. Even if a policy expressly provides for payment in case of suicide, it is unenforceable.

In India suicide is not a crime. Only the attempt to commit suicide is a crime. Therefore it has been held in a case that a policy cannot be avoided on the ground of suicide unless there is a clause in the policy to that effect. *Northern India Insurance Co. v. Kanya Lal*.⁵

THE PAYMENT OF CLAIMS

Claims are payable according to the terms of the contract of insurance. In case of an endowment policy, the money must be paid to the assured or, if the policy was assigned, to the assignee. In case of whole life insurance, the money is payable to the assignee or the nominee or, in the absence of assignment or nomination, to the legal representatives of the assured.

The death of the assured must be proved. Proof of death may be given by oral testimony or by a death certificate or by presumptive evidence viz. absence for a period of seven years or more. The insurer may claim the production of a succession certificate.

Section 47 of the Insurance Act provides that where an insurer is of opinion that, by reason of conflicting claims to or insufficiency of proof of title or any other reason, it is impossible for the insurer to obtain a satisfactory discharge for the payment of the money insured for, the insurer may apply to pay the money in the court having jurisdiction over the place where the money is payable. The application

³ (1861) L. J. (Ch.) 511

⁴ (1938) A. C. 586

⁵ (1938) Lah 561

of the insurer must contain all particulars regarding the policy and must be filed at least six months *after* the maturity of the policy or the notice of death. The court shall give notice of the deposit of money to all the claimants and decide all questions relating to the disposal of the claims. Pending payment to the successful claimant, the money may be invested in government securities.

Section 47A of the Act provides that in case of policies for a sum not exceeding Rs. 2,000, the dispute may, at the option of the claimant, be referred to the Controller of Insurance. The decision of the Controller shall be final and can be executed by the court which would have had jurisdiction to decide the case had it not been referred to the Controller.

PROOF OF AGE

The age of assured is a material fact. It is particularly important in endowment policies under which the money is payable on the assured attaining a certain age. Age may be proved by any evidence which is satisfactory *e.g.* the production of a horoscope or a birth certificate (where available) or any family record or document. The age is recorded in the policy. After satisfactory evidence is given of the age the insurer generally writes on the policy, "age admitted" or similar words. Once the age is admitted in this manner it cannot be challenged, except in cases of fraud. Section 45 of the Insurance Act provides that a statement made in the policy cannot be questioned after two years unless there is fraud or a fraudulent concealment.

THE LIFE INSURANCE CORPORATION ACT, 1956

Life insurance business in India has been brought under State-ownership and State-management by the Life Insurance Corporation Act of 1956.

The object of the Act is to nationalise the business of life insurance in India with a view (i) to ensure absolute security to the policy-holder, (ii) to spread insurance much more widely and in particular to the rural areas, and (iii) to secure a more effective mobilisation of public savings and the investment of such savings under the five year plans.

The Act creates a Life Insurance Corporation which is responsible for all life insurance in India. Section 30 of the Act provides that the Corporation shall have the exclusive privilege of carrying on life insurance business in India.

Constitution of the Life Insurance Corporation. The Corporation

consists of not more than 15 persons appointed by the Central Government, one of whom shall be appointed Chairman. Only those persons shall be appointed members who have no financial or other interest of such a nature as to affect prejudicially the exercise of their functions as members of the Corporation.—Sec. 4.

The original capital of the Corporation was Rs. 5 crores to be provided by the Central Government. The Government may, on the recommendation of the Corporation, reduce the capital to the extent and in such manner as the Government may determine.—Sec. 5.

Functions of the Corporation. Subject to the rules, if any, made by the Central Government, it shall be the duty of the Corporation to carry on life insurance business whether in or outside India, and the Corporation shall so exercise its powers under the Act as to secure that life insurance business is developed to the best advantage of the community.—Sec. 6.

Without prejudice to the generality of the provisions mentioned above, the Corporation shall have power :

- (a) to carry on capital redemption, annuity and reinsurance business ;
- (b) to take such steps as are expedient for the protection or realisation of its investments, including the taking over and administering any property offered as security ;
- (c) to acquire, hold and dispose of any property for the purpose of its business ;
- (d) to transfer the whole or any part of the life insurance business carried on outside India to any other person or persons if it is expedient to do so ;
- (e) to advance or lend money upon the security of movable or immovable property or otherwise ;
- (f) to borrow or raise money in such manner and upon such security as the Corporation may think fit ;
- (g) to carry on either by itself or through any subsidiary any other business in any case where such business was being carried on by a subsidiary of an insurer whose controlled business has been transferred to and vested in the Corporation under the Act ;
- (h) to carry on any other business which may seem to the Corporation to be capable of being conveniently carried on in connection with its business and calculated directly or indirectly to render profitable the business of the Corporation ;
- (i) to do such things as may be incidental or conducive to

the proper exercise of any of the powers of the Corporation.

In the discharge of any of its functions the Corporation shall act so far as may be on business principles.—Sec. 6.

The central office of the Corporation shall be at a place to be decided by the Central Government. There shall be zonal offices at Bombay, Calcutta, Delhi, Kanpur, Madras and such other places as the Corporation may decide. There may be divisional offices and branches within each zone.—Sec. 18.

The Corporation may entrust the general superintendence and direction of its affairs to an executive committee consisting of not more than five of its members. There may be other committees *e.g.* an investment committee. The Corporation may appoint one or more Managing Directors and Zonal Managers. The Corporation shall have its own funds and its accounts shall be audited by chartered accountants. A copy of the audit report and annual report must be sent to the Central Government and laid before Parliament.

The Corporation shall, once at least in two years, cause an investigation to be made by actuaries into the financial condition of the business of the Corporation, including a valuation of the liabilities of the Corporation. The actuarial report shall be sent to the Central Government.

In the discharge of its functions under the Act, the Corporation shall be guided by such direction in matters of policy involving public interest as the Central Government may give to it in writing; and if any question arises whether a direction relates to a matter of policy involving public interest, the decision of the Central Government thereon shall be final.

EXERCISES

1. State the effect of (i) an assignment of a policy of life insurance and (ii) a nomination by a holder of a policy of life insurance and how they are to be effected. (C.A., May '50)

2. Discuss the liability of insurers on a life insurance policy in case of suicide of the assured (i) where the policy is silent and (ii) where the policy excludes liability in case of suicide. (C.A., Nov. '50)

3. What is the difference between an assignment of a life insurance policy and a nomination by the holder of a life policy and how are they effected? (C.A., Nov. '52)

4. (a) Examine if a contract of life insurance is a contract of indemnity.

(b) Is the validity of a contract of insurance affected by the fact that the assured ceases to have an insurable interest in the life on which the contract is made before the happening of the event insured against?

(c) Is the consent of the insurer necessary for an assignment of a life policy? (C.A., May '53)

CHAPTER 3

FIRE INSURANCE

DEFINITION

Fire insurance means insurance against any loss caused by fire. Section 2 (6A) of the Insurance Act defines fire insurance as follows : "Fire insurance business means the business of effecting, otherwise than incidentally to some other class of business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies."

What is a 'Fire'? The term fire in a Fire Insurance Policy is interpreted in the literal and popular sense. There is fire when something burns. In English cases it has been held that there is no fire unless there is *ignition*. *Stanley v. Western Insurance Co.*¹ Fire produces heat and light but either of them alone is not fire. Lightning is not fire. But if lightning ignites something, the damage may be covered by a fire-policy. The same is the case with electricity.

CHARACTERISTICS OF FIRE INSURANCE

1. Fire insurance is a contract of indemnity. The insurer is liable only to the extent of the actual loss suffered. If there is no loss there is no liability even if there is a fire.

2. The contract of insurance is embodied in a policy called the fire policy. Such policies usually cover specific properties for a specified period.

3. **Insurable Interest.** A fire policy is valid only if the policy-holder has an insurable interest in the property covered. Such interest must exist at the time when the loss occurs. In English cases it has been held that the following persons have insurable interest for the purposes of fire insurance : owners ; tenants ; bailees, including carriers ; mortgagees and charge-holders

4. In case of several policies for the same property, each insurer is entitled to contribution from the others. After a loss occurs and payment is made, the insurer is subrogated to the rights and interests of the policy-holder. An insurer can reinsure a part of the risk.

¹ (1868) L. R. 3 Ex 71

5. Fire policies cover losses caused proximately by fire. The term loss by fire is interpreted liberally.

Example :

A woman hid her jewellery under the coal in her fireplace. Later on, she forgot about the jewellery and lit the fire. The jewellery was damaged. Held, she could recover under the fire policy. *Harris v. Poland.*¹

Nothing can be recovered under a fire policy if the fire is caused by a deliberate act of the policy-holder. In such cases the policy-holder is liable to criminal prosecution.

Fire policies generally contain a condition that the insurer will not be liable if the fire is caused by riot, civil disturbances, war and explosions. In the absence of any specific exception the insurer is liable for all losses caused by fire, whatever may be the cause of the fire.

6. **Assignment.** According to English law a policy of fire insurance can be assigned only with the consent of the insurer. In India such consent is not necessary and the policy can be assigned as a chose in action under the Transfer of Property Act. The insurer is bound when notice is given to him. But the assignee cannot recover damages unless he has an insurable interest in the property at the time when the loss occurs. A stranger cannot sue on a fire policy.

7. **Payment of claims.** Fire policies generally contain a clause providing that upon the occurrence of fire the insurer shall be immediately notified so that the insurer can take steps to salvage the remainder of the property and can also determine the extent of the loss. Insurance companies keep experts on their staff to value the loss. If in a policy there is an intentional overvaluation of the property by the policy-holder, the policy may be avoided on the ground of fraud.

TYPES OF FIRE POLICIES

There may be various types of fire policies. The principal types are described below.

Specific Policy. A specific policy is one under which the liability of the insurer is limited to a specified sum which is less than the value of property.

¹ (1941) 1 K. B. 462

Valued Policy. A valued policy is one under which the insurer agrees to pay a specific sum irrespective of the actual loss suffered. A valued policy is not a contract of indemnity.

Average Policy. Where a property is insured for a sum which is less than its value, the policy may contain a clause that the insurer shall not be liable to pay the full loss but only that proportion of the loss which the amount insured for, bears to the full value of the property. Such a clause is called the average clause and policies containing an average clause are called average policies. The words "subject to average" is equivalent to the insertion of an average clause. Lloyds' Fire Policies are usually expressed to be "subject to average".

Reinstatement or Replacement Policy. In such policies the insurer undertakes to pay not the value of the property lost, but the cost of replacement of the property destroyed or damaged. The insurer may retain an option to replace the property instead of paying cash.

Floating Policy. When one policy covers property situated in different places it is called a floating policy. Floating policies are always subject to an average clause.

Combined Policies. A single policy may cover losses due to a variety of causes e.g. fire together with burglary, third party losses, etc. A fire policy may include loss of profits, *i.e.* the insurer may undertake to indemnify the policy-holder not only for the loss caused by fire but also for the loss of profits for the period during which the establishment concerned is kept closed owing to the fire.

EXERCISES

1. Explain the different types of fire policies.
2. What are the characteristics of fire insurance ?

CHAPTER 4

MARINE INSURANCE

DEFINITION

A contract of Marine Insurance has been defined by Halsbury as a contract whereby, "the insurer undertakes to indemnify the assured in the manner and to the extent thereby agreed, against marine losses, that is to say losses incidental to marine adventure".

Section 2(13A) of the Insurance Act defines marine insurance business as "the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured".

In England the law relating to marine insurance is covered by statutes. In India there is no separate statute concerning marine insurance. It is governed by the general law relating to contracts and certain provisions of the Insurance Act. The forms of policies used in India closely resemble English policies, particularly those of Lloyds. The Bombay High Court in *Ramchandra v. Gomitbar*¹ held that the practice of marine insurance in Bombay is borrowed from English usage.

THE REQUISITES OF A VALID MARINE INSURANCE POLICY

A marine insurance policy to be valid must fulfil the following requirements :

1. The contract must be written in a document called a sea-policy or a marine insurance policy. The document must be stamped in accordance with the provisions of the Stamp Act. The policy must specify the particular risk or adventure or the time for which it is undertaken, the names of the underwriters and the amount of money payable. No contract of marine insurance can be made for a period exceeding one year.

The above rules are contained in Section 7 of the Indian Stamp Act. In practice marine policies issued in India include in addition to the particulars provided for by the Stamp Act, the particulars which are usually included in English marine policies, by virtue of the provisions of the English law on the subject.

¹ A. I. R. (1926) Bom 82

2. A contract of marine insurance must fulfil all the essential elements of a valid contract.

3. A marine policy is enforceable only if the policy-holder has an insurable interest. For the purpose of marine insurance every person who has an *interest* in the marine *adventure* is deemed to have an insurable interest. Thus the following persons have insurable interest: the shipowner; the shipper and the consignee of cargoes; any person who has lent money on the security of the ship, the cargo or the freight; any person who has a lien on the ship or the cargo for any dues; the captain and the crew for their wages. /The insurable interest must exist at the time when the loss occurs./

4. The contract of marine insurance is a contract *uberrimae fidei* and therefore the insured must disclose all material facts. In case of mis-statement or fraudulent concealment the policy becomes bad and nothing can be recovered. Intentional overvaluation of goods with the object of cheating the underwriters comes within the category of fraudulent misrepresentation.

TYPES OF MARINE INSURANCE POLICIES

There are certain standard forms of marine insurance. As early as 1779 members of the Lloyds started using printed forms for entering into contracts of marine insurance. The Lloyds' policies are the recognised forms of marine insurance policies used by all underwriters. The principal types of marine policies are described below.

1. **The Valued Policy.** A valued policy is one in which the value of the ship or the goods insured, is specified. In a valued policy the liability of the insurer in cases of total loss is defined and fixed by the value specified.

2. **The Open Policy.** The open policy is one in which the value of the subject-matter insured is not mentioned. In case of loss or damage, the extent of the liability of the insurer has to be determined by valuation

3. **The Voyage Policy.** A voyage policy is one which insures a ship or its cargo for a particular voyage, e.g. Calcutta to Madras.

4. **The Time Policy.** The time policy is one in which insurance is made for a specified period of time. In a time policy there may be a "continuation clause" providing for an extension of the risk beyond the fixed date in case the ship does not reach its destination by the fixed date.

There may be mixed policies combining the elements of a voyage

policy and a time policy, e.g. a policy covering risk for three months during a voyage from Calcutta to San Francisco.

5. The Floating Policy. The floating policy is one in which the name of the ship insured is not disclosed at the time the policy is made but is written down on the policy at a later time.

6. Wagering Policies. Sometimes marine insurance contracts are entered into with persons who have no insurable interest. Such policies are void according to law but the insurer may fulfil his obligations out of considerations of honour. One typical form of a wagering policy is known as the P. P. I. policy (policy proof of interest).

THE LLOYD'S POLICY

During the 18th. and the 19th. century marine insurance business in Great Britain was mostly done by an association of underwriters known as the Lloyds of London. From 1779 the members of the Lloyds started using printed policy forms in which the terms of the contract of insurance were incorporated. At present marine insurance is undertaken not only by the Lloyds underwriters but also by many insurance companies. The policy forms used are mostly based upon the forms used by the Lloyds.

A Lloyds Policy contains clauses dealing with all essential matters concerning the contract of insurance. Thus it includes the name of the insured or his agent; the name of the ship; the subject-matter of insurance; the extent and the duration of the risk, the express warranties; and, various conditions which limit and modify the liability of the insurer. Some important points concerning the clauses in a Lloyds policy are explained below.

The Parties to the Policy. The policy contains the names of the insured and the insurer. In case of loss a suit may be brought either by the insured or his agent or his broker. Since a marine insurance policy can be assigned, the assignee can sue if he had insurable interest at the date of the loss.

The Subject-Matter of Insurance. It is necessary to specify with certainty the subject-matter insured. The policy may cover a ship or the goods taken on board a ship or both. It is usual to mention the name of the ship. In a Floating Policy the name of the ship is not entered at the time the policy is effected but is endorsed on the policy later. The insurance of a ship includes the furniture, fittings, machinery and stores. The insurance of goods includes merchandise and not the personal belongings of the crew and passengers. In the absence of custom to the contrary, goods on a ship do not include deck cargo

and living animals. The insurance of a ship or goods on a ship does not include insurance of freight or of profits. If it is intended to insure such items there must be a specific contract to that effect.

The "Lost or not lost" clause. A marine insurance policy may contain a clause providing that the policy will be valid even if the goods are (unknown to the parties) already lost or have already reached their destination. Such a clause is known as the "lost or not lost clause." The effect of the clause is to make the contract of insurance binding even though the parties were under a mistake of fact (*viz.* that there was no risk to be insured against).

The Duration of the Risk. The time from which the liability of the insurer commences and the period during which he remains liable depends on the language of the policy. The liability may start from the time the ship sets sail or may commence from the time the ship enters a specified port. The first situation is covered by what is called the "From" clause and the latter by the "At and From" clause. The liability of the insurer usually continues until the ship "hath moored at anchor twenty-four hours in good safety".

Deviation. A marine insurance policy usually mentions the ports where the ship can touch and the period of time it can stay in each such port. This clause is known as the "Touch and Stay" clause. If the names of the ports are not mentioned the ship can touch and stay at the ports which are by custom touched and stayed at by ships using the route involved.

If a ship touches and stays at a port not permitted under the terms of the policy or not usually or customarily touched by ships using the route there is said to be Deviation. Deviation is permitted in the following cases:

1. A ship may deviate from the course if it is rendered necessary by storm, cyclone or any other natural cause.

2. If the captain finds it necessary to deviate in order to maintain the seaworthiness of the ship. An unexpected breakdown of machinery or loss of supplies or men may make it necessary to proceed to the nearest port even though it may be a port not mentioned as a permissible place to touch.

3. Deviation is permitted to save life and property, to rescue another ship in distress and in order to escape from pirates and enemies of the state.

4. The policy may allow deviation for other reasons *e.g.* barratry.

[Barratry means wilful acts of damages done by the crew in course of a mutiny or fight with the captain and the shipowner or among themselves.]

If a ship deviates for any reason other than those mentioned above, the liability of the insurer ceases and he is not liable for damage or loss.

The "Inchmaree" clause. Ordinarily the insurer under a marine insurance policy is liable only for loss or damage caused by a sea-peril.

Example :

The ship "Inchmaree" was lying at anchor at port and her donkey engine was pumping water into the boilers. The engineer in charge was negligent and kept a valve of the engine closed whereas it should have been kept open. As a result water was forced into the engine and the pump was broken. The shipowner claimed compensation from the insurer. It was held, that the loss was not due to a sea-peril and so the insurer was not liable. *Thames and Mersey Marine Insurance Co. v. Hawilton Fraser & Co.*²

Since the decision in the above case it has become customary to include a clause in all marine insurance policies by which the insurer agrees to pay compensation for loss or damage arising from causes which are not sea-perils or similar to sea-perils. Such a clause is called the Inchmaree clause.

The "Sue, Labour and Travel for" clause. This is a clause in a marine insurance policy which permits the captain to stop the ship, lower boats and engage mariners to sue, labour and travel in order to recover goods fallen overboard accidentally.

The F. C. & S. clause. A clause in a marine insurance policy may exempt the insurer from liability in case the ship is captured by enemies during war. Such a clause is called the F. C. & S. clause ("Free of Capture and Seizure").

The F.P.A. and the F.A.A. clause. A policy may exempt the insurer from liability from particular or general average contribution. F. P. A. stands for "Free from particular average contribution" and F. A. A. for "Free from all average" contribution.

The Memorandum or the N.B. clause. The memorandum or the N.B. (*nota bene*) clause exempts the insurer from liability for partial losses in the case of perishable goods. In a Lloyds policy it is usually stated that the insurer will not be liable for losses to goods like sugar, hemp, tobacco etc. unless the loss is 5% or more of the value of the goods. The N.B. clause may limit the liability in any other way.

The Running Down clause. A clause in the policy may make the insurer liable for negligent actions of the captain and crew of the insured ship. For example if by negligence a collision occurs and the

² (1887) 12 A. C. 484

shipowner has to pay compensation to some other person, the insurer may agree to indemnify the insured. Such a clause is called "Running Down" clause.

WARRANTIES IN A CONTRACT OF MARINE INSURANCE

In marine insurance contracts the term Warranty is used to denote certain *conditions* which are considered to be *essential* to the contract of insurance.

A warranty in a marine insurance contract may be Express or may be Implied. Express warranties are those which are expressly mentioned in the policy of insurance. Implied warranties are stipulations which are, by custom or general agreement, assumed to be included in the agreement although not mentioned in the policy.

Express Warranties. The following conditions are generally included in all marine insurance policies as express warranties :

1. The ship is fit and seaworthy.
2. The ship will sail on a specified day and will proceed to the destination without unnecessary deviation.
3. The ship is a neutral vessel and the cargo is neutral and will remain so during the voyage.

There may be any other stipulation expressly mentioned.

Implied Warranties. In a contract of marine insurance the following warranties are implied.

1. In a voyage policy there is an implied warranty that the ship is seaworthy at the time of commencement of the voyage and that while at port the ship is fit to encounter the ordinary perils of the port where she is. As regards the goods carried there is an implied warranty that the ship is fit to carry the goods to the agreed destination.

A ship is said to be seaworthy when she is fit to undertake the voyage agreed upon and is properly equipped and manned for the purpose.

2. There is an implied warranty that the voyage is lawful.

There is no implied warranty about the nationality of the ship or any undertaking that the nationality will not be changed during the subsistence of the policy.

Effect of Breach of Warranty. If there is breach of warranty, the insurer can avoid liability on the policy. But in the following cases the insurer remains liable even if there is a breach of warranty—

- (i) if the breach is due to change of law or to circumstances beyond the control of the policy-holder; and
- (ii) if the insurer waives the breach.

LOSSES

The liability of the insurer arises when there is loss. Loss may be of two kinds: Total or Partial.

Total Loss is again of two kinds: Actual Total Loss and Constructive Total Loss. Actual Total Loss occurs when the subject-matter of the insurance is totally destroyed or is so damaged that it ceases to be the thing which was insured. Constructive Total Loss occurs when the thing insured has to be abandoned or where it cannot be retained without unreasonable expense.

Partial Loss occurs when the subject-matter of insurance is partially lost. Partial Loss may be either a particular average loss or a general average loss. (See *ante* under Law of Carriage).

EXERCISES

1. Write notes on any two of the following: Floating Policy of Marine Insurance; Implied warranties in a voyage policy; General Average Loss and Particular Average Loss; Assignment of a Fire Insurance Policy. (C U. '54)

2. What are the points of difference between marine and non-marine insurance? (C.A., May '54)

CHAPTER 5

MISCELLANEOUS TYPES OF INSURANCE

INSURANCE AGAINST PERSONAL ACCIDENTS

A contract of personal accident insurance is a contract by which the insurer promises to pay a certain sum of money to the insured in case of injury by accident and to the dependents of the insured in case of death by accident. A personal accident insurance is not a contract of indemnity because the insurer has to pay a fixed sum of money. He is not required to indemnify the assured. The contract of insurance is made in the same manner as other forms of insurance, *i.e.* by the payment of premium and taking out a policy. The contract must satisfy all the essential requirements of an insurance contract *e.g.* there must be no concealment of any material fact. In U. K. accident insurance policies for a specified journey can be effected easily by filling out a form and paying the premium. For railway journeys a coupon for accidents can be purchased along with the purchase of the ticket. In India insurance against railway accidents is almost unknown but insurance against accidents during air journeys is very popular.

Accident insurance policies generally contain various conditions safeguarding the interests of the insurer. For example the policy may provide that the insurer will not be liable for accidents if the assured engages in any unusual trade or occupation involving more than ordinary dangers or if the assured incurs accident while under the influence of drink.

The insurer in an accident policy is liable only if the injury or death is due to an accident and not due to natural causes. It is difficult to define what is an accident. Lord Macnaughten¹ has defined an accident as an "unlooked for mishap, or an untoward event which is not expected or designed." If a man deliberately jumps down from the roof of a house and dies, it is not an accident; but if he slips and falls from the roof without intending to do so, it is an accident.

Insurance against personal accident may be and usually is a part of motor car insurance.

¹ *Fenton v. Thorley* (1903) A.C. at p. 448

BURGLARY INSURANCE

Goods may be insured against theft or robbery. The policy in such cases lays down what risks are covered. The policy-holder is usually required to take all reasonable precautions against loss by theft or robbery. In burglary and accident insurance there is usually a provision that notice of loss or accident must be given to the insurer immediately or as soon as possible.

FIDELITY INSURANCE

A contract of Fidelity Insurance promises to indemnify the employer against loss caused by misappropriation of funds or damage to property committed by an employee. Such insurance may be effected by the employee or by the employer with the insurance company. There may be a collective policy covering all employees.

MOTOR CAR INSURANCE

A policy of motor car insurance may cover three different types of risks, *viz.* (i) loss of or damage to the car by accident (ii) injuries to or death of any passenger by accident and (iii) damages payable to third parties by the owner of the car for accidents. The same policy may cover all three risks. The last item mentioned above is called insurance against third party risks. According to the Motor Vehicles Act of 1939 every owner of a motor vehicle must take out a policy covering third party risks. Insurance against the other two forms of risk is optional.

Where an insurance policy covers third party risks, the third party who has suffered damage can sue the insurance company even though he was not a party to the contract of insurance.

THE ALL IN ONE POLICY

An insurance policy may cover different types of risks simultaneously. Thus there may be a policy combining insurance against fire, accident, burglary, third party losses, etc.

PROVIDENT SOCIETIES

A Provident Society means a person, association or company which enters into contracts of insurance for the payment of annuities of Rs. 100 or less or for the payment of a gross sum not exceeding Rs. 1,000 on the occurrence of any one of the following contingencies :

- (a) birth, marriage or death of any person or the survival by a person of a stated or implied age or contingency ;
- (b) failure of issue ;
- (c) the occurrence of a social, religious or other ceremonial occasion ;
- (d) loss of or retirement from employment ;
- (e) disablement in consequence of sickness or accident ;
- (f) the necessity of providing for the education of a dependant ;
- (g) any other contingency which may be provided for by the State Government with the approval of the Central Government.—Sec. 65, Insurance Act.

Sections 65A to 94 of the Insurance Act contain certain restrictions on Provident Societies and provisions regarding their registration and the rules regarding the investment of their funds etc.

MUTUAL INSURANCE COMPANY

A Mutual Insurance Company means a company carrying on the business of insurance which has no share capital and of which by its constitution all policy-holders and only policy-holders are members.—Sec. 95 (1) (a), Insurance Act.

CO-OPERATIVE LIFE INSURANCE SOCIETY

A Co-operative Life Insurance Society means a co-operative society which carries on the business of life insurance and which has no share capital on which dividend or bonus is payable and of which by its constitution only the original members of the society and the policy-holders are members.—Sec. 95 (1) (b), Insurance Act.

CHAPTER 6

THE INSURANCE ACT, 1938

The Insurance Act of 1938 was passed with the object of consolidating the law relating to insurance in India. The Act deals mainly with the constitution and management of insurance companies in India. The Act contains a few provisions regarding the general law of insurance. These general provisions have been mentioned in the previous chapters. In this chapter some of the provisions relating to the constitution and management of insurance companies are described.

INSURER

Insurer means any person, association or corporation carrying on the business of insurance in India or any person who has a standing contract with any underwriter who is a member of the Society of Lloyds whereby such person is authorised to issue protection notes, cover notes or other documents granting insurance cover to other persons on behalf of the underwriters.—Sec. 2(9).

Section 2C provides that after the commencement of the Insurance (Amendment) Act of 1950, the business of insurance in India can be carried on only by a public company, incorporated in India or outside India and by a society registered under the Co-operative Societies Act.

Every insurance company must be registered under the Insurance Act, the certificate of registration being issued by the Controller of Insurance appointed under the Act. Before such a certificate is issued the Controller must be satisfied that the company fulfils the requirements regarding capital etc. as provided under the Act. The Controller may under certain circumstances cancel the registration of the insurance company.

The business of life insurance in India has been nationalised by the Life Insurance Corporation Act of 1956. The principal provisions of this Act have been mentioned in the chapter on life insurance.

Rules regarding capital structure and voting rights of shareholders: The provisions of the Act of 1938 regarding these matters were applicable to life insurance companies. They are therefore of no effect at present.

RULES REGARDING DEPOSITS

Every insurer (not being one doing business on behalf of a Lloyds underwriter) shall deposit and keep deposited with the Reserve Bank of India for and on behalf of the Central Government the amount specified below, either in cash or approved securities or partly in cash and partly in approved securities : (Sec. 7).

- (a) where the business done or to be done is life insurance only, two hundred thousand rupees ;
- (b) where the business done or to be done is fire insurance only, one hundred and fifty thousand rupees ;
- (c) where the business done or to be done is marine insurance only, one hundred and fifty thousand rupees ;
- (d) where the business done or to be done is miscellaneous insurance only, one hundred and fifty thousand rupees ;
- (e) where the business done or to be done is life insurance and any one of the three classes specified in clauses (b), (c) and (d), three hundred thousand rupees of which two hundred thousand rupees shall be the deposit for the life insurance business ;
- (f) where the business done or to be done is life insurance and any two of the three classes specified in clauses (b), (c) and (d), four hundred thousand rupees of which two hundred thousand rupees shall be the deposit for life insurance business ;
- (g) where the business done or to be done is life insurance and all three classes specified in clauses (b), (c) and (d), four hundred and fifty thousand rupees of which two hundred thousand rupees shall be the deposit for life insurance business ;
- (h) where the business done or to be done does not include life insurance but is any two of the classes specified in clauses (b), (c) and (d), two hundred and fifty thousand rupees ;
- (i) where the business done or to be done does not include life insurance but is all three classes specified in clauses (b), (c) and (d), three hundred and fifty thousand rupees ;

Provided that, where the business done or to be done is marine insurance only, and relates exclusively to country craft or its cargo or both, the amount to be deposited under this sub-section shall be ten thousand rupees only.

The deposits can not be assigned or charged and shall not be liable to attachment in execution of any decree obtained by a policy-holder.

ACCOUNTS AND AUDIT

Every insurer is required to prepare at the end of each year a balance sheet, a profit and loss account and a revenue account in the form prescribed under the Act. The accounts must be audited by a chartered accountant. Life insurance companies were required to prepare an actuarial report once in five years.—Sections 11, 12 and 13.

THE CONTROLLER OF INSURANCE

The Central Government may by notification in the official gazette appoint a person to be the Controller of Insurance in India. This officer controls the administration of insurance business in India and is entrusted with the duty of enforcing the provisions of the Insurance Act. He has been given various statutory powers and duties.

REGISTER OF POLICIES AND CLAIMS

Every insurer is required to keep a Register of Policies in which is kept a record of every policy issued, its date, the name and address of the policy-holder and particulars regarding every transfer, assignment or nomination by the policy-holder of which notice is received by the insurer. The insurer is also required to keep a Register of claims in which is recorded the date of every claim made against the insurer, the name and address of the claimant, the date when the claim was paid and if rejected, the grounds of rejection.—Sec. 14.

LOANS AND INVESTMENTS

Sections 27, 27A and 28 lay down the rules regarding the investment of the funds of insurance companies. A list is given of the type of shares and securities in which the funds can be invested. They include government securities, preference shares of companies which have paid dividends on its ordinary shares for the preceding 5 years, first mortgages on immovable properties etc. Section 29 restricts the powers of insurance companies as regards the grant of loans to its directors, managers etc.

INSURANCE AGENTS

Insurance Agents are persons who procure business for insurance companies and receive a commission. They must obtain a licence from the Controller for periods of 3 years at a time. The Act of 1938 laid down maximum rates of remuneration of agents at the following figures: (i) life-insurance business—40% of the first year's premium and 5% of a renewal premium: (ii) other types of insurance—15% of the premium.—Sections 40, 42.

WINDING UP OF INSURANCE COMPANIES

Section 53 of the Insurance Act provides that an insurance company can be wound up by the court on any of the following grounds:

1. Any ground for which a company may be wound up under the Companies Act.

2. If, with the previous sanction of the court, an application for winding up is presented by (i) not less than one-tenth of the shareholders holding not less than one-tenth of the whole share capital or (ii) not less than fifty policy-holders holding policies of life insurance that have been in force for not less than three years and are of the total value of not less than Rs. 50,000.

3. If the Controller of Insurance applies for winding up on any of the following grounds:

- (a) the company has failed to deposit or keep in deposit the amount required to be so kept under Sections 7 and 98;
- (b) the company having failed to comply with any requirement of the Act or having contravened any provision of the Act, has continued such contravention for a period of three months after notice of such contravention or non-compliance was conveyed to the company by the Controller;
- (c) if it appears from the returns filled by the company or from the results of any investigation made under the Act, that the company is insolvent; or
- (d) if the continuance of the company is prejudicial to the interests of the policy-holders.

BOOK IX
THE LAW OF INSOLVENCY
CHAPTER I
PROCEEDINGS PRELIMINARY TO ADJUDICATION

WHAT IS INSOLVENCY?

The terms "insolvent" and "insolvency" have not been defined in the statutes relating to the subject. According to popular usage an insolvent is one who is unable to pay his debts. But no man can be called "insolvent" unless a competent court declares him to be one. The statutes relating to insolvency lay down the procedure by which a person can be declared insolvent and the rules to be followed in distributing the properties of such a person among his creditors.

INSOLVENCY LEGISLATION

The law relating to insolvency in India is contained in two statutes: The Presidency Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920. The former applies to the presidency towns, *i.e.* to Calcutta, Bombay and Madras. The latter applies to all areas other than the three towns mentioned above. The two Acts are based on the same principles. The differences between them relate mostly to matters of procedure.

The Indian Acts relating to insolvency are based upon the English statutes on the subject. In English law the terms "bankrupt" and "bankruptcy" are used in the same sense as the terms insolvent and insolvency in India.

THE OBJECT OF INSOLVENCY LEGISLATION

Insolvency legislation has a two-fold objective: (i) protection of debtors and (ii) safeguarding, as far as possible, the interests of creditors.

The objects of insolvency legislation are sought to be achieved in the following way. After a person is declared insolvent by the court, his properties are taken over by an officer of the court (known as the Official Assignee or the Official Receiver). The properties are converted into cash and distributed among his creditors in proportion to

the claim of each. After the distribution is complete, the unpaid debts (except certain specified debts) are cancelled and the insolvent is allowed to engage in trade or service without any of his former obligations. The creditors lose a part of their claims, the debtor gets a fresh start in life.

Prior to the passing of insolvency legislation, a debtor who was unable to pay debts was regarded as a sort of criminal and was very often sent to jail. It was realised in course of time that inability to pay debts is more often due to misfortune than to misconduct and sending the debtor to jail is oppressive and unprofitable. Insolvency legislation provides a method by which the debtor can free himself from his past obligations and get a fresh start in life.

Insolvency legislation is also beneficial to the creditors. It ensures the equitable distribution of the debtor's remaining properties among all the creditors. If there were no insolvency laws the debtor would have been free to dispose of his properties in any way he liked. He might have wasted the properties or might have paid one creditor proportionately more than the other creditors. Because the court distributes the properties ratably each creditor is sure of getting at least something.

INSOLVENCY COURTS

In the Presidency towns, insolvency matters are dealt with by the High Courts. In other areas, such matters are dealt with by the District Courts. But courts subordinate to the district courts may deal with insolvency matters if they are so empowered by the State Government concerned. Insolvency courts have power to decide all questions relating to the realisation and distribution of the debtor's properties and the determination of all questions relating to priority of claims as between different creditors.

WHEN CAN A PERSON BE DECLARED INSOLVENT?

Two conditions must be satisfied before a person can be adjudicated insolvent : (i) he must be a debtor, *i.e.* he must owe money to others and his assets must be insufficient to meet all the claims upon them; and (ii) the debtor must have committed an Act of Insolvency.

Act of Insolvency. An Act of Insolvency is some act of the debtor which shows that he is financially embarrassed. Both the Presidency Towns Insolvency Act and the Provincial Insolvency Act contain a

list of acts which are to be considered Acts of Insolvency when committed by a debtor. Only those acts which are listed as such by the statutes mentioned above are considered to be Acts of Insolvency.

Each of the following acts committed by the debtor is an Act of Insolvency :

1. If in India or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally.

(The transfer of the bulk of a person's property for the benefit of creditors is clearly evidence of financial embarrassment and is therefore an act of insolvency. Any creditor, who is not a party to the transfer can apply for adjudication on this ground. The intention of the debtor does not matter, it is the fact of transfer which gives jurisdiction to the court. The transfer becomes void if the debtor is adjudged insolvent within three months of the transfer).

2. If in India or elsewhere, he makes a transfer of his property or any part thereof, with the intent to defraud or delay his creditors.

(In such cases it must be proved that the debtor had a dishonest intention—to defeat or delay creditors. Upon proof of such fact the court will issue an adjudication order. The transfer becomes void upon the passing of the order of adjudication).

3. If in India or elsewhere, he makes any transfer of his property or any part thereof which would under this (insolvency) or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent.

(Fraudulent preference occurs when an insolvent debtor prefers one creditor to another, *i.e.* pays one creditor more than what he would have received had the properties been ratably distributed—See *post*. Fraudulent preference amounts to an Act of Insolvency. Upon adjudication the creditor so preferred must refund the money obtained).

4. If, with intent to defeat or delay his creditors—

- (i) he departs from or remains out of India;
- (ii) he departs from his dwelling house or usual place of business or otherwise absents himself;
- (iii) he secludes himself so as to deprive his creditors of the means of communicating with him.

(The intention of the debtor—to defeat or delay his creditors—can be gathered from the circumstances.)

5. If any of his property has been sold or attached for a period

of not less than 21 days in execution of the decree of any court for the payment of money.

(Under the Provincial Insolvency Act only a sale in execution is an Act of Insolvency, not attachment in execution.)

6. If he petitions to be adjudged an insolvent.

7. If he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debt.

8. If he is imprisoned in execution of the decree of any court for the payment of money.

N.B. An act may amount to an Act of Insolvency even though committed by an agent of the debtor and not by the debtor himself.

PROCEDURE FOR OBTAINING AN ORDER OF ADJUDICATION

Order of Adjudication. The order of court by which a person is declared to be insolvent is called the Order of Adjudication.

Before the court can pass an order of adjudication there must be a petition presented to it either by a creditor or by the debtor. The petitioning creditor or debtor must fulfil certain conditions.

Conditions of a creditor's petition. The following conditions must be fulfilled before a creditor can present a petition for the adjudication of a person as insolvent :

1. The amount owed must be Rs. 500 or more. Two or more creditors may present a joint petition, in which case it is sufficient if the total claim of the creditors amount to at least Rs. 500 in all.

2. The debt is a liquidated sum payable either immediately or at some certain future time.

3. The debtor must have committed an act of insolvency within three months before the presentation of the petition.

A secured creditor *i.e.* one who holds some movable or immovable property of the debtor out of which he can realise his claims, is not ordinarily interested in insolvency proceedings because his dues are safe. But a secured creditor can present an insolvency petition if the following conditions are satisfied :

- (i) he abandons his security in favour of all the creditors, or
- (ii) the security is insufficient to meet his claims and the insufficiency amounts to at least Rs. 500. (In the latter case

he must in his petition mention the valuation of the security and show that he satisfies the conditions mentioned above regarding a creditor's petition.)

Conditions of a debtor's petition. A debtor is entitled to present a petition for the adjudication of himself as an insolvent if *any one* of the following conditions are fulfilled :

1. his debts amount to Rs. 500, or
2. he has been arrested and imprisoned in execution of the decree of any court for the payment of money, or
3. an order of attachment in execution of a money decree has been made and is subsisting against his property.

Procedure after the filing of an insolvency petition. A creditor's petition must be verified by an affidavit of the creditor or of some person having knowledge of the facts. At the hearing the court shall require proof of the debt of the petitioning creditor and of the debtor's act of insolvency. Notice of the petition must be given to the debtor. If all the necessary facts are proved the court will issue the order of adjudication. If the debtor appears and proves that he is not indebted or if he pays the amount due to the petitioning creditor no order of adjudication will be passed.

The court may at the time of presentation of the petition appoint an interim receiver to take charge of the properties of the debtor.

In the case of a debtor's petition, the debtor must prove that he is entitled to present the petition and upon such proof the court will issue an order of adjudication.

WHO CAN BE DECLARED INSOLVENT?

Any person, man or woman, who has attained majority can be declared insolvent if the conditions laid down in the insolvency acts are fulfilled. (See above under creditor's and debtor's petition.) Certain special cases are discussed below.

Minor. In India a minor is not personally responsible for his debts and is not capable of entering into contracts. Therefore, a minor cannot be adjudicated an insolvent. If by error a minor is adjudicated insolvent, the order must be annulled, *i.e.* cancelled.

Lunatic. A lunatic can be adjudged insolvent for debts incurred by him while he was sane. The other conditions necessary for passing an Order of Adjudication must be satisfied, *e.g.* there must be an act of insolvency. It must be noted that a lunatic cannot commit

those acts of insolvency which involve conscious volition, *i.e.* acts which involve intent. Thus an insolvent cannot stay away from his place of business "with intent to defeat and delay his creditors".

Married Women. In India a married woman does not suffer from any contractual incapacity. She can own property and contract debts. Therefore she can be declared insolvent under appropriate circumstances.

Foreigner. A foreigner can be adjudicated insolvent if he commits an act of insolvency in India while resident here.

Joint Debtors. When money is borrowed by two or more persons jointly, all of them can be declared insolvent on a single petition provided some act of insolvency is committed by each of them or jointly by all.

Partners. Since every partner is responsible for all the debts of the firm, the creditor of a firm can file an insolvency petition against any partner or all the partners for any debt due and owing by the firm. But it must be proved that the partner concerned has committed an act of insolvency. A minor partner cannot be declared insolvent for a partnership debt.

Under English law an adjudication order cannot be passed against a firm in the firm name. In India under both Presidency Towns Insolvency Act and the Provincial Insolvency Act an adjudication order can be passed against a firm in the firm name. Such an order is equivalent to the adjudication of all the partners (except a minor partner, if any) as insolvent.

Joint Hindu Family. A creditor of a joint Hindu family can present a petition for the adjudication of all the members of the family as insolvent provided the debt is one for which all the members are responsible and an act of insolvency has been committed by all the members jointly. Minor members will not be declared insolvent.

In the case of a joint Hindu family firm managed by the Karta, members who participate in the management and the Karta can be declared insolvent for debts due from the firm. If the management is solely in the hands of the Karta, only the Karta can be declared insolvent, because the other members are not personally responsible for the debts—they are responsible only to the extent of their share in the joint family properties.

Deceased Person. A dead man cannot be declared insolvent. His debts will be paid *pro rata* in course of the administration of his estate. If a debtor dies after the presentation of the insolvency petition, his

estate will be administered by the Official Assignee as upon insolvency, unless the court otherwise directs.

Legal Representative. The legal representative of a deceased debtor cannot be declared insolvent for a decree obtained against him as legal representative, because he is not personally responsible for such debts.

Companies. A company cannot be declared insolvent. In case of insolvent companies the proper procedure is winding up.

EXERCISES

1. What are the objects of insolvency law? How are they sought to be achieved? (C. A. Nov. '58)
2. "A petition for insolvency can be made only when the debtor has committed an act of insolvency." Explain. (C. U. '57)
3. On what grounds can an application be made for the adjudication of an insolvent? (C. U. '59)
4. Explain the significance of an act of insolvency in insolvency law and explain if the following can be adjudicated insolvents (i) a minor, and (ii) a firm. (C. A. May '58)
5. What is the legal significance of an act of insolvency? (C. A. May '60)

CHAPTER 2

PROCEEDINGS AFTER ORDER OF ADJUDICATION

LEGAL EFFECTS OF THE ORDER OF ADJUDICATION

The order of the court by which a person is declared insolvent is called the Order of Adjudication. Upon such an order being passed, the following consequences ensue :

1. **Properties of the insolvent.** The properties of the debtor (except properties held by him in trust for others and tools of trade, wearing apparel and similar items) vest in an officer of the court who is called the Official Assignee (under the Presidency Towns Insolvency Act) and the Official Receiver (under the Provincial Insolvency Act).

All the properties of the debtor in India (except the items mentioned above) automatically vest in the Official Assignee or the Official Receiver and the insolvent no longer possesses any power to deal with such properties in any way. As regards properties of the insolvent outside India, it has been held that movable properties vest in the same way as properties in India but immovable properties do not, unless the law of the country in which they are situated allow such vesting.

The Official Assignee or the Official Receiver takes possession of the properties, sells them and distributes the money among the creditors according to rules contained in the insolvency Acts.

2. **Suits against insolvent.** After the Order of Adjudication is passed no creditor can commence any suit or legal proceedings against the insolvent except with the leave of the insolvency court and subject to such terms and conditions as the insolvency court may impose. Suits already filed may be continued, but only with the leave of the insolvency court.

After insolvency proceedings commence, all unsecured creditors have the right to prove their claims before the Official Assignee or the Official Receiver and thereafter get a share of the remaining assets of the insolvent. The position of secured creditors is different.

3. **Personal Disqualifications.** Upon adjudication as an insolvent the debtor loses certain civic rights, *viz.* he cannot hold the post of a magistrate, or any office under a local authority, or be a member of a

local authority. These disqualifications are removed only if the order of adjudication is annulled (*i.e.* cancelled) or if the insolvent is discharged with a certificate from the court stating that his insolvency was caused by misfortune and not by misconduct. In addition to the disqualifications laid down under the insolvency acts, there are others imposed by different statutes. For example, under the Companies Act of 1956, an undischarged insolvent cannot act as director of a company.

4. Avoidance of Voluntary Transfers. A voluntary transfer is a transfer without consideration *e.g.* a gift. Under the Presidency Towns Insolvency Act all voluntary transfers (except transfers made by the insolvent to his wife on the occasion of his marriage) become void and inoperative if an order of adjudication is passed against the transferor within two years of the date of transfer. Under the Provincial Insolvency Act all such transfers made within two years of the date of presentation of the petition for adjudication become void if an order of adjudication is passed on the petition. The properties involved in the transfer vest in the Official Assignee or the Official Receiver as the case may be.

5. Avoidance of Fraudulent Preferences. Fraudulent Preference means any act of the debtor by which one creditor is preferred to another in the matter of payment of his dues. Such preference can be shown by transfer of property, payment of money or otherwise. Suppose that a person is indebted to X for Rs. 5,000, to Y for Rs. 4,000 and to Z for Rs. 2,000. His total assets amount to Rs. 3,000 and he transfers them to Y with the deliberate intention of giving an advantage to Y as against X and Z. This is fraudulent preference.

A fraudulent preference is an act of insolvency. When a debtor does an act which amounts to a fraudulent preference any of his creditors can, within three months of the act, file a petition for declaring him insolvent.

The Insolvency Acts provide that a fraudulent preference is void and inoperative if the following conditions are satisfied :

- (i) the debtor was in insolvent circumstances at the time the transfer was made, *i.e.* was unable to pay his debts as they fell due;
- (ii) the transfer was made in favour of a creditor and had the effect of preferring that creditor over others;
- (iii) the transfer was made by the debtor with a view to giving preference to that creditor; and
- (iv) the debtor was adjudicated insolvent on a petition presented within three months after the date of the transfer.

The money and property, received by the creditor who was fraudulently preferred, must be returned to the Official Assignee or Official Receiver if the debtor is adjudicated insolvent within three months of the date when the fraudulent preference occurred. But if the creditor had transferred any of the properties received by him to a *bona fide* purchaser for value, the transfer is valid and the rights of the transferee are not affected.

6. The Protection Order. Protection Order means an order by the court prohibiting the arrest of an insolvent debtor in execution of a decree for the payment of money. Under the Presidency Towns Insolvency Act such an order may be passed after the order of adjudication is passed and after the insolvent has filed a schedule of his assets. But the court may, at its discretion, issue a protection order before the filing of the schedule, if necessary. Under the Provincial Insolvency Act a protection order may be passed any time after the admission of the petition for adjudication. If an insolvent is already under arrest the court may order his release.

DUTIES OF THE DEBTOR

1. As soon as the petition for adjudication is admitted, the debtor must produce his books of account before the court.

2. Within 30 days of the date of the adjudication order (if the order is passed on the application of the debtor) and within 30 days of the service of the order of adjudication (if the order is passed on the application of a creditor) the insolvent must file a schedule of his assets and liabilities. The schedule must be verified by an affidavit and must contain an inventory of his properties and a list of his debts together with the names of the creditors. If without any reasonable excuse the insolvent fails to file a correct and proper schedule, he may be committed to prison by the court.

3. Public Examination of the Insolvent. Under the Presidency Towns Insolvency Act the court fixes a date for holding a public examination of the insolvent. The insolvent must, on the appointed date, attend court and answer all questions put to him by the court, the Official Assignee and any creditor. The object of the examination is to determine the causes which led to insolvency. The court may dispense with the holding of the public examination if the insolvent is a lunatic or a pardanashin woman or if he or she is suffering from some disease or disablement.

Under the Provincial Insolvency Act the court must examine the debtor while the petition for adjudication is being heard by the court.

During such examination the creditors present may put questions to the debtor.

4. The insolvent must attend any meeting of the creditors which the Official Assignee may require him to attend and must disclose before the meeting such information as may be required.

5. The insolvent must execute such powers of attorney, transfers and instruments as may be required by the Official Assignee or the Official Receiver and must do all such acts and things in relation to his properties as may be required by the Official Assignee or the Receiver. Failure to perform any of these duties amounts to contempt of court and the insolvent may be punished for it.

6. The insolvent must assist the Official Assignee, to the best of his ability, in the realisation of his property and the distribution of the property among the creditors.

PRIVATE EXAMINATION

The court may, on the application of the Official Assignee or the Official Receiver or any creditor who has proved his debt, summon before it the insolvent or any other person who is suspected or known to be in possession of property belonging to the debtor or is indebted to him or is capable of giving information regarding the insolvent's property or the causes of insolvency. When such persons attend, questions are asked by the court.

If the person summoned does not attend he may be arrested upon a warrant issued by the court.

If the person summoned admits that he is indebted to the insolvent, the court may issue an order for the payment of the money to the Official Assignee. Similar orders may be issued as regards any property of the insolvent held by the person examined. The orders of the court regarding payment of money or the delivery of property can be executed like decrees of a court.

PROPERTY OF THE INSOLVENT

The term property has been defined in the insolvency acts so as to include properties of which the insolvent is the owner and also properties over which he has a disposing power. Some of these properties are available for distribution among the creditors, some are not. Within the first category are included the following types of properties :

Properties available for distribution among creditors.

1. All properties, movable or immovable, of which the insolvent was the owner at the *date of commencement of insolvency* (except trust properties, tools of trade and certain other items). The following types of properties are available for distribution among creditors: immovable properties; cash in hand, jewellery and other movables; life insurance policies; patents and copyrights belonging to the insolvent; partnership assets, including goodwill in case of insolvency of a firm; leasehold interests; occupancy rights; actionable claims etc.

2. Properties which may be acquired by the insolvent or which may devolve upon him *after* the commencement of insolvency but *before* the date of discharge *e.g.* a legacy. As regards properties coming within this category it has been held, in several cases under the Presidency Towns Insolvency Act, that they do not vest automatically in the Official Assignee. The Official Assignee must intervene and claim the property. These decisions are based on the rule laid down in the English case, *Cohen v. Mitchell*.¹ Under the Provincial Insolvency Act, however, such properties vest automatically in the Official Receiver.

Salary earned by the insolvent after the commencement of insolvency must be handed over to the Official Assignee or Receiver except such portion of it as may be allowed to the insolvent for his maintenance.

3. If the insolvent has any power of disposal over some other person's property, which he can use for his own benefit, such power vests in the Official Assignee. *Example* - the power of the father in a Mitakshara joint family to dispose of the undivided interest of the son.

4. Goods of which the insolvent is the reputed owner vest in the Official Assignee. (See below.)

Property not divisible among creditors. Properties of the following types can be retained by the insolvent. They are not available for distribution among the creditors :

1. Properties held by the insolvent in trust or on behalf of other persons.

2. Under the Presidency Towns Insolvency Act, the insolvent can retain his tools of trade, wearing apparel and cooking utensils. The total value of all these things must not exceed Rs. 300.

¹ (1890) 25 Q.B.D. 262

3. Under the Provincial Insolvency Act, the insolvent is allowed to retain all those properties which are exempted from attachment and sale in execution of a decree, according to the provisions of the Civil Procedure Code. Such properties include wearing apparel, cooking utensils, tools of trade and certain other items.

4. The right to sue a third party for personal injuries does not vest in the Official Assignee or the Receiver. Similarly a *spes successionis*, i.e., a mere chance of getting some property upon the death of another does not pass upon insolvency.

5. Moneys in a recognised provident fund, gratuities payable to a Railway servant and pensions (subject to certain limits) are not available for distribution among creditors.

The Doctrine of Reputed Ownership. Goods left with the insolvent by others can be taken possession of by the Official Assignee or Receiver on behalf of the creditors under the circumstances mentioned below. This is known as the Doctrine of Reputed Ownership.

1. They must be movable goods.

2. They must be in the possession of the insolvent.

3. There must be no mark or other indication showing that the goods belong to some person other than the insolvent.

4. The circumstances are such that people dealing with the insolvent are likely to believe that the goods belong to the insolvent.

The sale proceeds of such goods are available for distribution among the creditors of the insolvent. The true owner of the goods can claim as a creditor of the insolvent for the value of the goods. His position is that of an unsecured creditor.

The Doctrine of Reputed Ownership does not apply in the following cases :

(1) Immovable properties. (2) Goods taken on hire-purchase. (3) Goods which were in the possession of the insolvent as repairer or carrier or commission agent or as pawnee. (4) Goods in the possession of the insolvent as trustee or administrator or executor or in any similar capacity.

THE DOCTRINE OF RELATION BACK

The insolvency of a person commences, not from the date when the order of adjudication is passed, but from an earlier date. The order of adjudication relates back and operates from an earlier date. This is known as the Doctrine of Relation Back.

Under the Presidency Towns Insolvency Act the insolvency of a debtor commences from the date when the first act of insolvency was committed by the debtor within three months before the date of presentation of the insolvency petition.

Under the Provincial Insolvency Act, the insolvency of the debtor commences from the date of presentation of the petition on which the order of adjudication was passed.

PROTECTED TRANSACTIONS

The term Protected Transaction is used to denote the transactions of the insolvent, in relation to his property, which are not invalidated by the insolvency proceedings. Such transactions can be classified as follows:

1. *Transactions entered into before the commencement of the insolvency proceedings.*

All such transactions are good except (i) transfers of property made without consideration within two years before the commencement of insolvency. Such transfers are called Voluntary Transfers and they can be set aside by the Official Assignee or the Receiver. But a voluntary transfer to the wife of the insolvent on the occasion of his marriage is not deemed to be a voluntary transaction and is protected. (ii) A transfer of property to a creditor under circumstances which amount to a fraudulent preference is not protected. Such a transfer can be avoided by the Official Assignee or the Receiver.

2. *Transactions entered into between the date of the filing of the insolvency petition and the Order of Adjudication.* Any such transaction is protected if (i) it is not a voluntary transfer or a transaction amounting to fraudulent preference, and (ii) the other party to the transaction had no knowledge of the presentation of the insolvency petition.

3. *Transactions entered into after the Order of Adjudication.* Such transactions are not protected. They are invalid and can be set aside by the Official Assignee or the Official Receiver.

POSITION OF SECURED CREDITORS

A secured creditor is one who has lent money to the insolvent on the security of some movable or immovable property. A secured creditor has the right to realise his dues in full out of the security given to him and this right is not affected by the insolvency proceedings. It is therefore said that a secured creditor stands outside the insolvency. But he can participate in the insolvency proceedings if he so desires.

When a debtor is declared insolvent, a secured creditor has the following options before him.

1. He can have the security sold. If the sale proceeds are greater than his dues, he must refund the excess to the Official Assignee or Receiver. If the sale proceeds are less than his dues, he can prove for the balance before the Official Assignee or Receiver. For this balance his position is like that of an unsecured creditor and he will get payment at the same rate as other creditors do.

2. He can surrender his security to the Official Assignee or Receiver and prove for his whole claim like an unsecured creditor. He will receive payment at the same rate as other unsecured creditors.

3. He can value his security and submit to the Official Assignee a claim for the balance, if any, together with a statement of the particulars of the security and the assessed value. In this case the Official Assignee can redeem the security by paying the assessed value.

POWERS OF THE OFFICIAL ASSIGNEE AND OFFICIAL RECEIVER

The Presidency Towns Insolvency Act provides that it is the duty of the Official Assignee to realise the properties of the insolvent and distribute the same among the creditors with all convenient speed. For this purpose he can exercise the following powers without leave of court :

(a) He can sell all or any part of the property of the insolvent.

(b) He can give receipts for any money received by him.

The Official Assignee can, *with the leave of the Court*, do all or any of the following things :

(i) carry on the business of the insolvent so far as may be necessary for the beneficial winding up of the same ;

(ii) institute, defend or continue any suit or other legal proceedings relating to the property of the insolvent ;

(iii) employ a legal practitioner or other agent to take any proceedings or do any business which may be sanctioned by the Court ;

(iv) accept as the consideration for the sale of any property of the insolvent a sum of money payable at a future time or fully paid shares, debentures or debenture stock in any limited company subject to such stipulations as to security and otherwise as the Court thinks fit ;

(v) mortgage or pledge any part of the property of the insolvent for the purpose of raising money for the payment of his debts or for the purpose of carrying on the business ;

(vi) refer any dispute to arbitration, and compromise all debts, claims and liabilities, on such terms as may be agreed upon ;

(vii) divide in its existing form amongst the creditors, according to its estimated value, any property which, from its peculiar nature or other special circumstances, cannot readily or advantageously be sold.

The official assignee shall account to the Court and pay over all moneys and deal with all securities in such manner as is prescribed or as the Court directs.

The powers and duties of the Official Receiver under the Provincial Insolvency Act are similar to those given to the Official Assignee.

Disclaimer of Onerous Property. "Onerous Property" means property which is subject to an obligation or liability. *Examples* : land, the ownership of which is subject to restrictive covenants or obliges the owner to some personal service ; shares on which there are unpaid calls ; property which is not readily salable. Unprofitable contracts, entered into by the insolvent, also come within this category.

Under the Presidency Towns Insolvency Act, the Official Assignee is given power to disclaim such property, *i.e.* refuse to accept it. Such disclaimer must be made by notice in writing signed by the Official Assignee within 12 months of the date of the Order of Adjudication or within 12 months of the date on which the Official Assignee came to know of the existence of such property.

Disclaimer of onerous property is essential to prevent the Official Assignee from being burdened with the obligations connected with the onerous property. Whenever the liabilities relating to a property are larger than its value, disclaimer is made.

Upon disclaimer the rights, interests and obligations of the insolvent relating to the disclaimed property come to an end. A person who is affected by the exercise of the right of disclaimer is treated as a creditor of the insolvent to the extent of the damage suffered by him and can prove for the same as a debt under insolvency.

The Official Assignee cannot disclaim a leasehold interest without the leave of the Court.

DUTIES OF THE OFFICIAL ASSIGNEE/RECEIVER

1. He must realise the property of the insolvent with all convenient speed.
2. Money received by him must be kept and accounted for according to the rules made by the court.
3. He must distribute the moneys received by him among the creditors without showing any partiality to any particular creditor.

4. He must pay due regard to the wishes of the creditors as indicated in meetings of creditors and must submit schemes of arrangement and composition, if any, before the creditors.

MEETINGS OF CREDITORS

The Presidency Towns Insolvency Act provides that the Court may, any time after passing the Order of Adjudication, and upon the application of the Official Assignee or any creditor, direct that a meeting of the creditors be convened for the purpose of considering the causes and circumstances that led to the insolvency, the insolvent's schedule and the mode of dealing with the insolvent's estate. Subject to the provisions of the Act and the directions of the Court, the Official Assignee must have regard to the wishes of the creditors as expressed in the resolutions passed in the creditors' meetings.

THE COMMITTEE OF INSPECTION

It is provided by both the Insolvency Acts that the Court may authorise the creditors who have proved their debts to appoint from among themselves a committee to be known as the Committee of Inspection. The duties of the Committee of Inspection are as follows :

(i) to convey to the Official Assignee or Receiver the wishes of the creditors ; and

(ii) to keep watch over the administration of the estate of the insolvent.

Details regarding the powers of the Committee of Inspection are prescribed in the insolvency rules framed by the High Courts.

"COMPOSITION" AND "SCHEMES OF ARRANGEMENT"

After insolvency proceedings commence, the debtor can come to an understanding with the creditors regarding the payment of the debts. Such understanding or settlement may be of two types: (i) it may be a "composition" of the debts or (ii) it may be a "scheme of arrangement". When the debtor pays immediately, or by agreed instalments, some money to the creditors less than what is due to them and the latter agree to accept such lesser amount in full satisfaction of their claims, there is said to be a composition of the debts. On the other hand when the debtor and the creditors agree to a scheme by which the debts are gradually liquidated (perhaps without selling all the debtor's assets) there is said to be a "scheme of arrangement".

A proposal for composition or arrangement must be submitted

to the Official Assignee or Receiver after the Order of Adjudication is passed. The Official Assignee or Receiver must thereupon submit the proposal before a meeting of the creditors. If in such creditors' meeting a majority in number and three-fourths in value of the creditors who have proved their claims, agree to accept the proposal it is put up before the Court for approval. Before giving approval the Court shall consider the conduct of the insolvent and the objections of dissentient creditors, if any. If, after hearing the Official Assignee and the creditors, the Court is of opinion that the proposal is reasonable and beneficial to the general body of creditors, it will give its sanction. The Court will not sanction any composition or scheme of arrangement in the following cases :

1. If it considers the proposal to be unreasonable and not beneficial to the creditors.

2. In cases coming under the Presidency Towns Insolvency Act, if the circumstances are such that the court must refuse, suspend or attach conditions to the debtor's discharge, the Court will not sanction a scheme of arrangement or composition unless it provides reasonable security for the payment of at least four annas in the rupee on all unsecured debts proved against the insolvent.

3. In cases coming under the Provincial Insolvency Act under circumstances similar to those mentioned above, the Court will not sanction any composition or scheme of arrangement unless there is reasonable security for the payment of at least six annas in the rupee.

When the Court sanctions a composition or scheme of arrangement, its terms shall be recorded in the order of the Court, the insolvency proceedings shall be terminated and the Order of Adjudication shall be annulled.

If the insolvent defaults in carrying out the terms of the composition or arrangement, or if the Court is of opinion that it cannot be carried on without unnecessary delay, or if the Court finds that the approval of the Court was obtained by fraud, the composition or scheme of arrangement will be annulled and the debtor will be re-adjudged insolvent.

PROOF OF DEBTS

The following debts can be proved in insolvency proceedings :

1. Debts incurred by the insolvent for a fixed or ascertained sum of money.
2. Claims for which a decree has been passed by a court of law.

3. Unascertained claims for damages arising from breach of contract or breach of trust.

The following debts cannot be proved in insolvency proceedings :

1. Unascertained claims, except those arising from breach of contract or breach of trust.

2. Debts the value of which cannot be estimated and debts which are illegal, immoral or against public policy.

3. Under the Presidency Towns Insolvency Act, debts contracted from a person who has knowledge of the presentation of the insolvency petition, cannot be proved.

Mode of Proof of Debts. Debts are provable according to the method laid down by the rules of the High Court concerned. Under the Presidency Towns Insolvency Act the usual procedure is that the creditor has to send a registered letter to the Official Assignee with an affidavit containing particulars of the claim. The Official Assignee may ask for the production of vouchers or other evidence of the claim. Under the Provincial Insolvency Act the claim has to be submitted to the Court.

RULES REGARDING THE DISTRIBUTION OF THE INSOLVENT'S PROPERTY

Out of the assets realised by the sale of the insolvent's properties, the Official Assignee or Receiver must retain such sums as are necessary for meeting the costs, charges and expenses of administering the estate of the insolvent. The balance is to be distributed among the creditors in the following order :

1. Payment must be made *first* to meet the following claims—

1. Debts due to the Government or any local authority.

2. Wages of any clerk, servant or labourer employed by the insolvent for services rendered during four months previous to the presentation of the insolvency petition, subject to the following limits : (i) under the Presidency Towns Insolvency Act—Rs. 300 for a clerk and Rs. 100 for each servant or labourer (ii) under the Provincial Insolvency Act—Rs. 20 for each.

3. Under the Presidency Towns Insolvency Act arrears of rent of the landlord for one month.

4. Arrears of compensation payable to a workman under the Workmen's Compensation Act.

The debts mentioned above rank equally and must be paid in full before any payment can be made for other debts. If the assets are

not sufficient to pay all these debts in full, they abate in the same proportion (*i.e.* they are reduced in equal proportion).

II. If any assets are left after paying the preferential claims mentioned above, the balance is distributed among the unsecured creditors ratably. In case of insufficiency all claims abate proportionately.

Interest. No interest runs after the Order of Adjudication is passed. Creditors can claim interest on their debts up to the date of the order of adjudication to the extent interest is allowable under the law for the debt in question.

If, however, it is found that the assets are sufficient to pay all creditors in full and a surplus exists in the hands of the Official Assignee or Receiver, interest will be paid to the creditors for the period after the Order of Adjudication at the rate of 6% per annum.

Mutual Dealings and Set off. When there are mutual dealings between the insolvent and a creditor, an account is taken and the creditor is allowed to claim for the balance due, if any. In such accounting the sums paid by one party to the other are set off against sums received by him. But if a creditor who has given credit to the insolvent did so with the knowledge of the presentation of an insolvency petition, he cannot claim the benefit of any set-off.

Dividends. The Official Assignee or Receiver is required to complete the distribution of the insolvent's property with all convenient speed. The insolvency rules therefore provide that some amount shall be distributed within one year of the adjudication order unless the Court is satisfied that there is good reason for postponing payment. The first instalment of payment is called the first dividend. Subsequent dividends are required to be declared and distributed at intervals of six months until the whole estate is administered. The amount of each dividend depends on the amount collected and the amount which the Official Assignee or Receiver must keep in his hands for disputed claims and his costs, charges and expenses.

ANNULMENT OF THE ORDER OF ADJUDICATION

The Order of Adjudication will be annulled, *i.e.* cancelled in the following cases:

1. Where the Order of Adjudication was wrongly passed *e.g.* when it is found that the person adjudicated is a minor or lunatic or otherwise outside the jurisdiction of the court, or where it is found that the order was passed on the petition of a person who was not entitled to present the petition.

2. Where it is proved to the satisfaction of the Court that the debts have been paid in full.

3. Where it is found that the same person has been adjudicated insolvent by more than one court, the insolvency proceedings will continue in one court only and the orders of the other courts must be annulled.

4. When a composition or scheme of arrangement is sanctioned by the court, the Order of Adjudication must be annulled.

5. The adjudication may be annulled if the insolvent does not appear on the date fixed for the hearing of his application for his discharge or does not apply for discharge within the period specified by the Court.

The effects of annulment vary according to the circumstances under which the annulment is made. But all acts done by the Official Assignee or the Receiver prior to the annulment remain good. After the Order of Adjudication is annulled the properties of the insolvent remaining undisposed of, again vest in him and all processes and remedial measures in force against him on the date of the adjudication order again revive.

SMALL INSOLVENCIES

The Insolvency Acts provide for a summary procedure when the estate of the insolvent is small. Under the Presidency Towns Insolvency Act an insolvency is considered small when the value of the insolvent's estate is not likely to exceed Rs. 3,000 and under the Provincial Insolvency Act Rs. 500. In case of small insolvencies the insolvency rules are modified in the manner stated below.

Under the Presidency Towns Insolvency Act :

- (a) no appeal shall lie from any order of the Court, except by leave of the Court ;
- (b) no examination of the insolvent shall be held except on the application of a creditor or the official assignee ;
- (c) the estate shall, where practicable, be distributed in a single dividend ;
- (d) such other modifications as may be prescribed with the view of saving expense and simplifying procedure.

There can be no modification of the provisions of the Act relating to the discharge of the insolvent.

The Court may at any time, if it thinks fit, revoke an order for the summary administration of an insolvent's estate.

Under the Provincial Insolvency Act :

- (a) unless the Court otherwise directs, no notice required under this Act shall be published in the Official Gazette ;
- (b) on the admission of a petition by a debtor, the property of the debtor shall vest in the Court as a receiver ;
- (c) at the hearing of the petition, the Court shall enquire into the debts and assets of the debtor and determine the same, by order in writing, and it shall not be necessary to frame a schedule under the provisions of Section 33 ;
- (d) the property of the debtor shall be realised with all reasonable despatch and thereafter, when practicable, distributed in a single dividend.
- (e) the debtor shall apply for his discharge within six months from the date of adjudication ; and
- (f) such other modifications as may be prescribed with the view of saving expense and simplifying procedure :

Provided that the Court may at any time direct that the ordinary procedure provided for in this Act shall be followed in regard to the debtor's estate and thereafter the Act shall have effect accordingly.

EXERCISES

1. Who can be declared an insolvent ? State the effects of Fraudulent Preference in case of insolvency. (C.U. '60)
2. Discuss the Doctrine of Relation Back with regard to the insolvent's property. (C.U. '50; C.A., May '59)
3. What are the consequences of the Order of Adjudication ? (C.U. 47; C.A., Nov. '50)
4. Explain the Doctrine of Reputed Ownership (C.U. '54; C.A., May '51)
5. What claims are and what are not, provable in insolvency ? (C.U. '54; C.A., May '51)
6. Enumerate the duties of an insolvent after adjudication. (C.A., Nov. '50)
7. Explain the different types of property which vest in the Official Assignee or Official Receiver, on the adjudication of the debtor as insolvent. (C.A., May '59)
8. Explain what is meant by Protected Transactions. Give illustrations. (C.A., May '58)

9. On what grounds can an order of adjudication be annulled under the insolvency acts? What are the effects of such annulment? (C.A., Nov. '52)
10. Discuss the effects of insolvency upon antecedent transactions. (C.A., May '54)
11. What are the powers of the Official Assignee or Receiver as to the realisation of the properties of the insolvent? (C.A., May '54)
12. Write short notes on any three: Protection Order; Fraudulent Preference; Reputed Ownership; Adjudication Order; Onerous Property; Acts of Insolvency. (C.U. '56)
13. Enumerate the different types of debts which are entitled to priority in the distribution of the property of an insolvent. (C.A., May '61)
14. State the difference between Composition of debts and Scheme of arrangement of the affairs of an insolvent and the procedure for obtaining the approval of court for same. (C.A., June '56)
15. What is "fraudulent preference" under the Insolvency Law? State its effects on insolvency proceedings. (C.U. B.Com '62)

CHAPTER 3

DISCHARGE OF THE INSOLVENT

The Order of Discharge. The Order of Discharge is an order of the court by which the insolvent is released from the burden of his pre-existing debts (except certain special types of debts) and is relieved of the personal disqualifications which follow from insolvency. From the date of the Order of Adjudication to the date from which the Order of Discharge operates, the debtor is an "undischarged insolvent". After the Order of Discharge, the term "insolvent" can no longer be applied to him.

Both the insolvency Acts provide that the insolvent can apply for discharge any time after the passing of the Order of Adjudication. Under the Presidency Towns Insolvency Act this application will not be heard until after the public examination of the insolvent, unless such public examination has been dispensed with. Under the Provincial Insolvency Act the Court is required to fix a date within which the insolvent must apply for discharge.

Powers of the Court. When the application for discharge has been received the Court fixes a date for hearing it. Before passing any order the Court must hear the report of the Official Assignee or the Receiver regarding the conduct of the insolvent and his dealings with his properties. The Court also hears the representations of the creditors, if any. After hearing all these parties the Court may,

1. grant an absolute order of discharge ;
2. refuse to pass any order of discharge ;
3. pass an order of discharge but suspend the operation of the order for a specified period ; or
4. grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the insolvent, or with respect to his after-acquired property.

Circumstances under which the Court must refuse an order of discharge. Under the Presidency Towns Insolvency Act, the Court must refuse to pass the order of discharge if the insolvent has committed an offence punishable under the Insolvency Act or under Sections 421 to 424 of the Indian Penal Code. The offences punishable under the Insolvency Act are : fraudulent concealment of the insolvent's state of

affairs by destruction of documents ; keeping false books ; failure to attend public examination without sufficient reasons etc. The offences punishable under the Indian Penal Code are : fraudulent removal, concealment, or disposal of property to prevent its distribution among his creditors ; fraudulently preventing debts from being realised by creditors ; false and fraudulent recitals regarding consideration or interest of the transferee in documents by which property is transferred by the insolvent.

Conditional discharge. It is provided by the Presidency Towns Insolvency Act that under the circumstances mentioned below, the court can either *refuse discharge* or issue a *conditional order of discharge* :

(a) The insolvent's assets are not of a value equal to four annas in the rupee on the amount of his unsecured liabilities, unless he satisfies the court that the insufficiency of assets has arisen from circumstances for which he cannot be held responsible. (Under the Provincial Insolvency Act the insolvent's assets must amount to at least eight annas in the rupee.)

(b) The insolvent has omitted to keep such books of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the three years immediately preceding his insolvency.

(c) The insolvent has continued to trade after knowing himself to be insolvent.

(d) The insolvent has contracted any debt provable under the Act without having at the time of contracting it any reasonable or probable ground of expectation (the burden of proving which lies on him) that he will be able to pay it.

(e) The insolvent has failed to account satisfactorily for any loss of assets or any deficiency of assets to meet his liabilities.

(f) The insolvent has brought on or contributed to his insolvency by rash or hazardous speculations or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs.

(g) The insolvent has put any of his creditors to unnecessary expense by a frivolous or vexatious defence to any suit properly brought against him.

(h) The insolvent has, within three months preceding the time of presentation of the petition, incurred unjustifiable expense by bringing a frivolous or vexatious suit.

(i) The insolvent has within three months preceding the date

of the presentation of the petition, when unable to pay his debts as they become due, given an undue preference to any of his creditors.

(j) The insolvent has concealed or removed his books or his property or any part thereof or has been guilty of any other fraud or fraudulent breach of trust.

The power of suspending and of attaching conditions to an insolvent's discharge may be exercised concurrently.

On any application for discharge, the report of the official assignee shall be *prima facie* evidence and the Court may presume the correctness of any statement contained therein.

The provisions of the Provincial Insolvency Act are more or less similar to those mentioned above.

Conditions that might be imposed. When a conditional order of discharge is issued, the Court can impose any one or more of the following conditions :

1. Payment by the insolvent to the Official Assignee or the Receiver of the whole or any part of his future earnings or after-acquired property.
2. Keep the order of discharge suspended until a dividend of at least four annas in the rupee has been paid to the creditors.
3. Require the insolvent to consent to a decree being passed in favour of the Official Assignee for any unsatisfied balance or part thereof of his debts provable in insolvency, to be executed later on.

EFFECTS OF THE ORDER OF DISCHARGE

Subject to certain exceptions, an absolute order of discharge (i) releases the insolvent from all debts which were provable in insolvency and (ii) removes the personal disqualifications from which an undischarged insolvent suffers, *e.g.* inability to hold certain posts. •

Exceptions: The order of discharge does not release the insolvent from the following debts—

1. A debt due to the Government (*e.g.* unpaid taxes or money due for purchasing goods from a Government-owned establishment).
2. Any debt or liability incurred by means of fraud or fraudulent breach of trust (*e.g.* a promoter's liability for making secret profits is not terminated by his insolvency).
3. Any debt or liability in respect of which the insolvent has obtained forbearance by means of fraud.

4. Any order for maintenance in favour of the wife or children of the insolvent issued under the Criminal Procedure Code.

Debts and liabilities of the aforesaid type continue after the order of discharge. The insolvent is bound to meet these obligation from his after-acquired property or earnings.

Debts incurred by the insolvent after the order of adjudication but before discharge remain binding upon him, because such debts are not provable in insolvency.

The order of discharge does not really terminate the insolvency proceedings. The Court retains power to direct the distribution of the properties remaining in the hands of the Official Assignee or Receiver and in case there was an error in their distribution the Court has power to direct a redistribution. A creditor who failed to prove his claim before discharge can prove his claim after discharge provided there are assets in the hands of the Official Assignee or the Receiver and provided he can be paid without disturbing the previous distribution.

It is to be noted that an order of discharge does not release any person who, at the date of the presentation of the petition, was a partner or co-trustee with the insolvent or was jointly bound or had jointly made a contract with him, or any person who was a surety, or in the nature of a surety, for him.

The insolvent is not exempted from punishment for violations of the penal provisions of the Insolvency Acts merely because of the fact that he has obtained his discharge (or that a composition or scheme of arrangement regarding his affairs has been sanctioned by the Court).

EXERCISES

1. What is meant by "discharge" of an insolvent? State the exact effects of an order of discharge. (C.U. '51; C.A., May '53)
2. What matters should be taken into consideration by the court in dealing with an application for the discharge of an insolvent? What is the effect of an order of discharge? (C.A., May '52)
3. Explain what is meant by discharge of an insolvent and what are the grounds on which absolute discharge may not be granted. (C.A., Nov. '58)

BOOK X
ARBITRATION

CHAPTER I
GENERAL PROVISIONS

WHAT IS ARBITRATION?

Arbitration means the settlement of a dispute by referring the dispute to a third party and abiding by his decision. Arbitration is less costly than a suit in a court of law. It is also more expeditious. Therefore, commercial contracts frequently contain a clause providing for a reference to arbitration in case a dispute breaks out concerning any matter relating to the contract. The policy of the legislature in India has always been to encourage settlement of disputes by arbitration. Also, in India, reference of disputes to the *Panch* or the *Panchayet* is a traditional and widely used method of settling disputes.

The law relating to arbitration in India is contained in the Arbitration Act of 1940.

THE ARBITRATION AGREEMENT

An arbitration agreement means "a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not."—Sec. 2 (a).

An arbitration agreement, to be valid and binding, must be in writing. Such an agreement must satisfy all the essential elements of a valid contract. Signatures of the parties are not necessary but it must be shown that they agreed to the settlement of disputes by arbitration. It is not necessary that the agreement should be contained in a formal document. The record of such an agreement in a clause in the contract or in a letter or memorandum is enough. It is not necessary that the name of the person who will act as the arbitrator should be mentioned in the agreement. The agreement may be to refer present differences or possible future differences to arbitration.

When there is an arbitration clause in a contract and the contract comes to an end owing to frustration¹ or is avoided on the ground of fraud or misrepresentation, the arbitration clause may continue to be

¹ See Law of Contract, Ch. 12.

binding. *State of Bombay v. Adamjee*.² But if the parties were not *ad idem* i.e., if there was no contract at all, the arbitration clause is not binding. *Tolaram v. Birla Jute Manufacturing Co.*³ The agreement to refer disputes to arbitration is not valid if it lacks the essential elements of a contract, e.g., if it was brought about by fraud or coercion.

The arbitration agreement or the arbitration clause in an agreement is sometimes called "Submission". This latter term was used in the acts relating to arbitration in India prior to the Act of 1940. In the corresponding English Act the term "Submission" is used.

EFFECTS OF AN ARBITRATION AGREEMENT

When some persons have entered into an agreement to refer disputes relating to a matter to arbitration they may be prevented from agitating the same matter in a court of law. Thus an arbitration agreement is a bar to a civil suit relating to matters covered by the arbitration agreement. If any of the parties to the agreement disregards the agreement and files a suit, the other party to the agreement may file an application for staying the suit. Section 34 of the Act empowers the court to stay the suit if the following conditions are satisfied :

1. The suit or proceedings relate to the same matter as that covered by the arbitration agreement. No stay will be granted if the suit relates to matters outside the scope of the arbitration agreement. If the suit relates partially to matters included in the agreement, the court may stay the suit or not according to its discretion.

2. It must be shown that the party desiring stay was and is ready and willing to proceed with the arbitration and do everything necessary for the purpose.

3. The party desiring stay must not have filed his written statement (i.e. his defence to the suit) or taken any step in connection with the defence against the suit (e.g. an application for extension of time to file the written statement).

4. The arbitration agreement must not have been the result of fraud and there must not exist any other sufficient reason why the dispute should not be decided by arbitration.

The grant of stay is discretionary. But unless there is a strong reason to the contrary the court will, by staying the suit, force the parties to abide by the arbitration agreement. The burden of proof is upon the party opposing stay to convince the court that there are reasons for continuing the suit or proceedings and not granting the stay.

² A.I.R. (1951) Cal. 147

³ (1948) 2 Cal. 171

The principles stated above were reiterated by the Supreme Court in the recent case. *Anderson Wright Ltd. v. Morgan & Co.*⁴

WHO CAN REFER DISPUTES TO ARBITRATION?

The arbitration agreement is a contract. Therefore, only those persons, who are capable of entering into contracts, can refer disputes to arbitration. A minor or a lunatic cannot refer disputes to arbitration but the guardian of a minor or a lunatic can do so on his behalf. In a suit or proceeding the next friend or guardian *ad litem* cannot enter into any compromise on behalf of a minor without the leave of the court. A partner can refer disputes relating to the firm to arbitration provided such power is given to him by the partnership agreement. An agent cannot refer disputes to arbitration unless specially authorised. Neither can solicitors.

MATTERS WHICH CAN BE REFERRED TO ARBITRATION

Subject to the exceptions noted below, all disputes which can be decided by a civil suit can also be decided by arbitration. *Examples* : Disputes about property or money; amount of damages payable for breach of contract; maintenance payable to wife; terms of separation between husband and wife; question of law; etc.

Matters of personal right (e.g. the right to hold the office of *Pujari* in a temple) and disputes regarding compliment or dignity, which cannot be decided by civil courts, can nevertheless be decided by arbitration.

The following matters cannot be referred to arbitration :

1. Matrimonial matters like divorce or restitution of conjugal rights.
2. Testamentary matters like the validity of a will.
3. Insolvency matters e.g. the adjudication of a person as insolvent.
4. Matters relating to the guardianship of a minor or of a lunatic or declaring a person insane.
5. Criminal matters. Whether a person is guilty of an offence or not, cannot be decided by arbitration.
6. Questions relating to charities or charitable trusts cannot be referred to arbitration except with the consent of the Advocate General in Presidency Towns and of the Collector of the place in other areas.

⁴ (1955) S.C.A. 165

DIFFERENT TYPES OF ARBITRATION

The Arbitration Act includes within its scope three types of arbitration :

1. Arbitration without the intervention of the court. Sections 3 to 25 of the Act relate specifically to this type of arbitration. In this case the arbitration proceedings take place outside the court. There is no suit pending but the award of the arbitrator can be filed in court and executed through the court as if it was a decree of the court.

2. Arbitration through court when no suit is pending.—Sec. 20.

3. Arbitration in suits.—Sections 21 to 25.

Thus a reference to arbitration may take place in three different ways.

Statutory Arbitration. Some statutes provide for compulsory arbitration in disputes arising out of matters covered by them, *e.g.* the Co-operative Societies Act, 1912; The Industrial Relations Act (Bombay). This is called Statutory Arbitration. The Statute concerned generally provides for the procedure according to which the compulsory arbitration will be conducted. If it does not, or if a question of procedure arises which is not covered by its provisions, the rules laid down in the Arbitration Act will apply [except Sections 6(1), 7, 12, 36 and 37].—Sec. 46.

EXERCISES

1. Explain a "submission to arbitration". What matters may be referred to arbitration? State the different ways in which such a reference or submission to arbitration may take place. (C.U. '55)

2. What is meant by an arbitration agreement and what is its effect? (C.A., Nov. '53)

3. What are the matters that cannot be referred and those that can be referred to arbitration? (C.A., Nov. '55)

4. Write notes on: Submission to arbitration. (C.U. '61).

CHAPTER 2

ARBITRATION WITHOUT THE INTERVENTION OF THE COURT

PROVISIONS IMPLIED IN AN ARBITRATION AGREEMENT

Section 3 and the First Schedule of the Arbitration Act provides that an arbitration agreement, unless a different intention is expressed therein, shall be deemed to include the following terms:

1. Unless otherwise expressly provided, the reference shall be to a sole arbitrator.

2. If the reference is to an even number of arbitrators, the arbitrators shall appoint an umpire not later than one month from the latest date of their respective appointments.

3. The arbitrators shall make their award within four months after entering on the reference or after having been called upon to act by notice in writing by any party to the arbitration agreement or within such extended time as the court may allow.

4. If the arbitrators do not make an award within the time mentioned above or if they notify any of the parties or the umpire that they cannot agree, the umpire must forthwith enter on the reference in lieu of the arbitrators.

5. The umpire shall make his award within two months of entering on the reference or such extended time as the court may allow.

6. The parties to the reference and all persons claiming under them must, if so required by the arbitrators or the umpire, submit to be examined by them upon oath or affirmation and must produce before them all necessary books, papers and documents and do all other things which, during the reference, the arbitrators or umpire may require.

7. The award shall be final and binding on the parties and persons claiming under them respectively.

8. The costs of the reference and award shall be in the discretion of the arbitrators or umpire who may direct to, and by whom, and in what manner, such costs or any part thereof shall be paid. The arbitrators or the umpire may tax or settle the amount of costs to be paid or any part thereof and may award costs to be paid as between legal practitioner and client.

THE APPOINTMENT OF ARBITRATORS

The general rule is that the parties to the dispute select the arbitrator or arbitrators by mutual consent. They can select any person or body of persons, whatever his or their qualifications may be. Sometimes it is arranged that each party to the dispute shall nominate one or more arbitrators and all such persons shall jointly act as arbitrators.

The parties to an arbitration agreement may agree that any reference thereunder shall be to an arbitrator or arbitrators to be appointed by a person designated in the agreement either by name or as the holder for the time being of any office or appointment.—Sec. 4. Thus the parties may agree that the arbitrator shall be appointed by the Bengal Chamber of Commerce or by the *Sirpanch* of a village.

It is an implied term of the arbitration agreement that if there is an even number of arbitrators and they do not agree on the award, they shall appoint another person to decide the matter. Such a person is called the Umpire. The Umpire's decision is final.

When there are more than two arbitrators, the decision of the majority is final, unless a contrary intention appears from the agreement. If they are equally divided, they must appoint an umpire.

Section 10 of the Act provides that where the agreement provides for a reference to three arbitrators, one to be appointed by each party and the third by the arbitrators, the agreement shall have effect as if it provided for the appointment of an umpire by the two arbitrators and not a third arbitrator.

Power of a party to appoint a new arbitrator or a sole arbitrator.

Section 9 of the Act lays down that where an arbitration agreement provides that a reference shall be to two arbitrators, one to be appointed by each party, the following rules shall apply :

(i) If either of the appointed arbitrators neglects or refuses to work, or is incapable of acting, or dies, the party who appointed him may, appoint a new arbitrator in his place.

(ii) If one party fails to appoint an arbitrator, either originally or by way of substitution as aforesaid, for 15 clear days after the service by the other party of a notice in writing to make the appointment (such other party having already appointed his arbitrator) the other party may appoint his arbitrator to act as the sole arbitrator in the reference, and his award shall be binding on both parties.

But the court may set aside any appointment as sole arbitrator under rule (ii) above and may, on sufficient cause shown, allow further time to the defaulting party to appoint an arbitrator or pass such other order as it thinks fit.

Power of the Court to appoint arbitrator or umpire. The need for appointing an arbitrator or umpire by the court may arise in the following cases :

(a) Where the agreement provides that the arbitrator or arbitrators shall be appointed by consent of all the parties and all parties do not concur in the appointments.

(b) If any appointed arbitrator or umpire neglects or refuses to work, or is incapable of acting, or dies, and the arbitration agreement does not show that it was intended that the vacancy should not be supplied, and the parties or the arbitrators as the case may be, do not supply the vacancy.

(c) Where the parties or the arbitrators are required to appoint an umpire and do not appoint him.

Section 8 of the Act provides that under any of the aforesaid circumstances any party may serve the other parties or the arbitrators, as the case may be, with a written notice to concur in the appointment or appointments or in supplying the vacancy.

If the appointment is not made within 15 clear days after the service of the said notice, the court may on the application of the party who gave the notice and after hearing the other parties appoint the arbitrator or arbitrators or umpire as the case may be. The person or persons appointed by the court shall have power to act in the reference in the same manner as if appointed by the consent of all parties.

Section 12(1) of the Act provides that where the court removes an umpire or one or more of the arbitrators for misconduct or any other reason, it can appoint persons to fill up the vacancy.

REVOCATION OF THE ARBITRATOR'S AUTHORITY

After the umpire and arbitrators are properly appointed, their authority can be revoked (*i.e.* cancelled) only under the following circumstances :

1. The arbitration agreement may provide for the revocation of the authority of the umpire or arbitrators.

2. The court can, under Section 5 of the Act, grant leave for such revocation. The court generally does it only if a just and sufficient cause is shown. *Example* : arbitrator not acting according to the rules of natural justice ; arbitrator acting in collusion with a party.

Effect of death of a party : The authority of an arbitrator is not revoked by the death of the party who appointed him. The death of a party does not discharge the arbitration agreement. In such cases

the award is enforceable against the legal representatives of the deceased.—Sec. 6.

Effect of insolvency: An arbitration clause in a contract entered into by a person who subsequently becomes insolvent, is binding on the Official Assignee or Receiver unless the contract is disclaimed as onerous property. If the contract is accepted, the arbitration clause must be accepted. The Official Assignee or Receiver can also enforce the arbitration clause.—Sec. 7.

REMOVAL OF ARBITRATOR OR UMPIRE

The court may on the application of a party, remove an arbitrator or umpire in the following cases :

1. If the arbitrator or umpire fails to use all reasonable despatch in entering on and proceeding with the reference and making an award.

2. If the arbitrator or umpire has misconducted himself or the proceedings.—Sec. 11.

[For the meaning of Misconduct—See *post* under, “When the court can set aside an award”.]

When an arbitrator or umpire is removed according to the above rules, he is not entitled to any remuneration.

When the court removes an umpire who has not entered into the reference, or one or more arbitrators (but not all the arbitrators) the court can appoint persons to fill the vacancy.

Where the authority of an arbitrator or arbitrators or of the umpire is revoked with the leave of the court or where the court removes an umpire who entered into the reference or a sole arbitrator or all the arbitrators, the court may on the application of any party,

(a) appoint a person to act as the sole arbitrator in place of the persons removed, or

(b) order that the arbitration agreement shall cease to have effect with respect to the difference referred.—Sec. 12.

DUTIES OF THE ARBITRATOR AND THE UMPIRE

1. The arbitrator and the umpire must, with all reasonable despatch, enter into the reference and make an award.

2. The arbitrator and the umpire hold a quasi-judicial position. They must decide the dispute impartially. An arbitrator is not the agent of the party appointing him. After the appointment is made he must not secretly communicate with him and must not accept any gift or payment from him.

3. The arbitrator or umpire is not required to follow the procedure of civil courts but they must observe the rules of natural justice (for example, both parties must be given a hearing in all matters).

4. The arbitrator and the umpire must not misconduct themselves in any way (*e.g.* accept bribes).

5. The arbitrator and the umpire must act within the scope of the arbitration agreement. They should sign and file the award within due time.

POWERS OF ARBITRATOR AND UMPIRE

Section 13 of the Act lays down that the arbitrator or umpire shall (unless a contrary intention is expressed in the agreement) have the following powers :

(a) to administer oath to the parties and witnesses appearing ;

(b) to state a special case for the opinion of the court on any question of law involved or state the award, wholly or in part, in the form of a special case of such question for the opinion of the court ;

(c) make the award conditional or in the alternative ;

(d) correct in an award any clerical mistake or error arising from any accidental slip or omission ;

(e) administer to any party to the arbitration such interrogatories (questions in writing) as may, in the opinion of the arbitrators or umpire, be necessary.

The arbitrators or the umpire may make interim awards to be followed by a final award.

THE ARBITRATOR'S REMUNERATION

The arbitrator's remuneration is determined by agreement between the parties and the arbitrator before arbitration proceedings commence. If there is no such agreement the arbitrator can fix his own remuneration. But if an unreasonably high charge is made, any of the parties can apply to the court under Section 38 of the Act whereupon the court determines what is reasonable remuneration for the arbitrator.

PROCEDURE AFTER AWARD IS MADE

The "Award" means the decision of the arbitrator or the umpire. When the arbitrators or the umpire have made their award, they shall sign it and shall give notice in writing to the parties of the making and signing thereof and of the amount of fees and charges payable in respect of the arbitration and award.

At the request of any party (after the costs and charges have been paid) or if the court so directs, the arbitrator or umpire shall file the award or a signed copy of it in court together with all depositions and documents which have been taken and proved before them. After they are filed the court gives notice to the parties.—Sec. 14.

Where the court sees no cause to remit, modify or set aside the award, it shall pass judgment in terms of the award and a decree shall follow. Such a decree is not appealable, except in so far as it is in excess of or not in accordance with the award.—Sec. 17.

“THE AWARD IS AN INSTRUMENT OF OFFENCE AND
DEFENCE”

The award of arbitrators and the umpire amounts to a final judgment as regards the matters referred to them. There can be no appeal against an award. An award can be modified, remitted or set aside only in certain cases provided in the Act. Apart from these cases, an award is final.

Any of the parties to the arbitration proceedings can have the award executed as a decree of the court. The award can therefore be called an instrument of offence.

Any matter decided by the award of arbitrators or an umpire validly made, cannot be re-opened by a suit. If a suit is filed on such a matter, it will be dismissed. The award therefore is an instrument of defence.

POWERS OF THE COURT IN RELATION TO
ARBITRATION PROCEEDINGS

The Act gives various powers to the court in relation to arbitration proceedings. A list of these powers is given below. The circumstances under which these powers are exercisable are laid down in the Act.

1. The court can give leave to a party to revoke the authority of the arbitrator appointed by him.—Sec. 5.
2. The court can appoint an arbitrator or umpire.—Sec. 8.
3. The court can remove arbitrators or the umpire and appoint other persons in their place or appoint some person as the sole arbitrator.—Sections 11 and 12.
4. The court can modify an award.—Sec. 15.
5. The court can remit an award for reconsideration.—Sec. 16.
6. The court can pass judgment in terms of the award and thereupon a decree is issued which is capable of execution.—Sec. 17.

7. The court can pass interim orders, wherever necessary (*e.g.* appoint receivers and issue injunctions).—Sections 18, 41 and the Second Schedule.

8. The court can supersede the arbitration agreement.—Sec. 19. Where an award has become void or has been set aside, the court may by order supersede the reference and shall thereupon order that the arbitration agreement shall cease to have effect with respect to the difference referred.

9. The court can enlarge the time for making an award.—Sec. 28.

10. When the award is for money, the court can in its decree order the payment of interest (at such rate as the court may consider reasonable) from the date of the decree.

11. The court can set aside an award.—Sec. 30.

12. The court can stay any suit or legal proceeding relating to a matter which is covered by a valid arbitration.—Sec. 34.

13. The Court can decide disputes as to arbitrators' remuneration and costs.—Sec. 38.

14. The court can issue processes for the appearance of witnesses before arbitrators.—Sec. 43.

WHEN AN AWARD CAN BE MODIFIED OR CORRECTED

The court can, by order, modify or correct an award in the following cases: (Sec. 15)

(a) Where it appears that a part of the award is upon a matter not referred to arbitration and such part can be separated from the other part and does not affect the decision on the matter referred; or

(b) where the award is imperfect in form, or contains any obvious error which can be amended without affecting such decision; or

(c) where the award contains a clerical mistake or an error arising from an accidental slip or omission.

WHEN AN AWARD CAN BE REMITTED FOR RECONSIDERATION

The court may from time to time remit the award or any matter referred to arbitration to the same arbitrators or umpire for reconsideration upon such terms as it thinks fit, in the following cases: (Sec. 16).

(a) Where the award has left undetermined any of the matters referred to arbitration, or where it determines any matter not referred

to arbitration and such matter cannot be separated without affecting the determination of the matters referred ; or

(b) where the award is so indefinite as to be incapable of execution ; or

(c) where an objection to the legality of the award is apparent on the face of it.

Where an award is remitted for reconsideration, the court shall fix a time within which the arbitrators and umpire shall file the fresh award. Such time may be extended. If no award is filed within the time allowed, the original award becomes void.

WHEN THE COURT CAN SET ASIDE AN AWARD

Section 30 of the Act provides that the court can set aside an award only in the following cases :

1. Where an arbitrator or umpire has misconducted himself or the proceedings.

Misconduct means improper conduct. The term covers moral turpitude and also failure on the part of the umpire or arbitrator to act according to the duties and responsibilities of his office. Any action or behaviour on the part of the arbitrator or umpire which shows the existence of partiality or a lack of judicial spirit amounts to misconduct. If the arbitrator or umpire is guilty of misconduct, the court will set aside the award. The following acts have been held to be misconduct under this section ; bribery ; undue partiality in favour of one party ; arbitrator secretly acquiring an interest in the subject-matter of the arbitration ; wrongfully refusing to hear a witness or a party ; etc.

2. If an award is made after the issue of an order by the court superseding the arbitration or after arbitration proceedings have become invalid under Section 35.

The court can supersede arbitration proceedings when an award becomes void or has been set aside. Arbitration proceedings become invalid when a suit or legal proceedings have been commenced relating to the subject-matter of the reference, notice of the same has been given to the arbitrator or umpire and none of the parties have asked for stay of the suit or legal proceedings. An award made under the aforesaid circumstances can be set aside by the court.

3. When an award has been improperly procured or is otherwise invalid. An award may become "otherwise invalid" for a variety of reasons. Some examples are given below : when the existence of the arbitration agreement cannot be proved ; when the consent of a party to an arbitration agreement has been procured by fraud ; when

the arbitrators or the umpire has been appointed in an improper manner; etc.

Procedure: To set aside an award there must be an application to the court under Section 30 or by a notice of motion.

EXERCISES

1. What is a submission? Can it be revoked? If so, how? In what cases would the courts set aside an award? (C.U. '46, '50)

2. Mention the powers of the courts in respect of an award in an arbitration proceedings. (C.U. '59; C.A., Nov. '60)

3. What are the provisions implied in an arbitration agreement without the intervention of the court? (C.U. '52, '58; C.A., Nov. '51, May '53, Nov. '55)

4. What are the powers and duties of an arbitrator? What amounts to misconduct on the part of an arbitrator sufficient to vitiate the award? (C.U. '56; C.A., Nov. '52)

5. What is 'legal misconduct' on the part of an arbitrator with reference to awards? (C.A. May '58)

6. Examine the circumstances when the court may modify or correct an award. (C.A. Nov. '58)

7. (a) When can an award be remitted for consideration of the same arbitrator?

(b) What are the grounds for setting aside an award under the Arbitration Act? (C.U. '57)

8. How is an arbitrator appointed? What are the effects of submission of a dispute to arbitration? (C.U. '60)

9. Write notes on Misconduct of an Arbitrator. (C.U. B.Com. '62)

CHAPTER 3

ARBITRATION IN OTHER CASES

ARBITRATION WITH INTERVENTION OF A COURT WHERE THERE IS NO SUIT PENDING

Where there is an arbitration agreement, the parties may proceed with the arbitration independently of any court, in the manner described in the last chapter. Section 20 of the Act, however, lays down an alternative procedure which the parties may follow.

Where there is an arbitration agreement, but no suit is pending, any of the parties may apply to the court for filing the *arbitration agreement*. The court thereupon issues notice to the other parties requiring them to show cause why the agreement should not be filed. Where no sufficient cause is shown the court shall order the agreement to be filed and shall make an order of reference to the arbitrators appointed in the manner laid down in the agreement, or, where the parties cannot agree upon an arbitrator, to an arbitrator appointed by the court. Thereafter the arbitration proceeds in the same manner out.

ARBITRATION IN SUITS

After a suit is filed, the parties may decide to settle the matter by arbitration. The procedure for doing so is laid down in Sections 21 to 25.

Where in any suit all the parties interested agree that any matter in difference between them in the suit shall be referred to arbitration, they may at any time before judgment is pronounced apply in writing to the court for an order of reference.

The arbitrator shall be appointed in such manner as the parties agree. (The parties may make the judge the arbitrator, in which case his judgment becomes an award and is not appealable.) There may be a reference of a part of the matter in issue in the suit, provided such part can be dealt with separately.

After an order of reference is made, the arbitration takes place in the same manner as an arbitration without the intervention of court.

FOREIGN AWARDS

The Arbitration (Protocol and Convention) Act, 1937 provides

that an award made in a foreign country will be enforceable in India, in the same manner as an award made in India, provided the following conditions are fulfilled :

1. The award relates to a matter considered as commercial under the law in force in India.

2. The award is made in a country with which India has a reciprocal agreement for the enforcement of awards and is one in which one of the parties is subject to the jurisdiction of a power with which there is such reciprocal arrangement.

3. The award is final, *i.e.* no proceedings are pending in the foreign country concerned for contesting the validity of the award.

The Act mentioned above was passed as a result of an international agreement for the enforcement of foreign awards. India was a signatory to the Protocol drawn in an international conference on the subject.

BOOK XI

MORTGAGE, CHARGE, HYPOTHECATION, LIEN

CHAPTER 1

MORTGAGE AND CHARGE

DEFINITION AND CHARACTERISTICS OF MORTGAGE

When a specific immovable property is made the security for the payment of money or the performance of an obligation, the transaction is called a mortgage.

Section 58 (a) of the Transfer of Property Act defines mortgage as, "transfer of an interest in specific immovable property, for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement which may give rise to a pecuniary liability".

The person transferring the interest (the debtor) is called the *mortgagor*. The person to whom the interest is transferred (the creditor) is called the *Mortgagee*. The amount secured is called the *Mortgage-money*. The document in which the transaction is recorded and by which the transfer of interest is made is called *Mortgage Deed*.

The characteristics of a mortgage :

1. In a mortgage there is a transfer of an interest in some specific immovable property.
2. The interest is transferred by way of security.
3. The security is for the due repayment of a loan or a debt, incurred or to be incurred for any purpose, or the performance of an engagement which may create a pecuniary liability.
4. If the money due or the pecuniary liability is not met within the agreed time, the interest transferred (*i.e.* the security) can be sold through the court and the dues recovered.
5. A valid mortgage can be effected only by a written document, signed by the mortgagor and two attesting witnesses, and registered. To this rule there are two exceptions : (i) In Calcutta, Bombay, Madras and certain other towns a mortgage can be made by handing over the title deeds of the property concerned, without any written and registered document (this is known as Equitable Mortgage). (ii) If the

sum secured is less than Rs. 100, mortgage can be made by delivery of possession of the property.

6. A mortgage is a contract. Therefore it must satisfy all the essential elements of a contract, *e.g.*, capacity of parties, free consent, etc.

CLASSIFICATION OF MORTGAGES

The terms and conditions incorporated in a mortgage deed may differ in different cases and accordingly there are different types of mortgage. The Transfer of Property Act classifies mortgages into the following six types :

1. **Simple Mortgage.** A simple mortgage has the following characteristics :

- (i) The mortgagor retains possession of the property.
- (ii) The mortgagee is given the right, in case of non-payment of the mortgage-money, to have the property sold through the court and realise his dues from the sale proceeds.
- (iii) The mortgagor undertakes that if the sale proceeds of the property are insufficient to repay the money due, the mortgagor will remain personally liable for the payment of the debt.

2. **Mortgage by way of Conditional Sale.** In this case the mortgage transaction is entered into the form of a sale. The characteristics are as follows :

- (i) The mortgagor ostensibly sells the property to the mortgagee.
- (ii) The mortgagee undertakes that if the mortgage-money is repaid on a certain date he will resell the property to the mortgagor or that the sale shall be void.
- (iii) The mortgagor agrees that if the mortgage-money is not repaid on the fixed date, the sale shall be absolute.
- (iv) The conditions regarding resale etc. are incorporated in the mortgage deed.

3. **English Mortgage.** An English mortgage is very similar to a mortgage by conditional sale. The characteristics are as follows :

- (i) The mortgagor sells the property *absolutely* to the mortgagee.
- (ii) The mortgagee agrees to reconvey the property to the mortgagor if the mortgage-money is paid up by a certain date.

An English mortgage differs from a mortgage by conditional sale in two respects *viz.* (a) in the former there is an undertaking by the mortgagor to repay the debt ; in the latter there is none ; (b) in the latter, the mortgagee cannot sue for the mortgage-money or for the sale of the property ; in the former he can.

4. Usufructuary Mortgage. The characteristics of an usufructuary mortgage are as follows :

- (i) The mortgagor delivers possession of the property to the mortgagee.
- (ii) The mortgagee takes the rents and profits of the property and appropriates the same to the interest and the principal sum due.
- (iii) When the full amount due has been recovered in the manner stated aforesaid, the mortgagee gives up possession of the property to the mortgagor.
- (iv) The mortgagee cannot sue for the mortgage-money or for the sale of the property ; his only remedy is to continue in possession till he gets back the money lent, together with interest.

5. Equitable Mortgage or Mortgage by Deposit of Title-deeds. In Calcutta, Bombay, Madras and other towns notified by the Government a mortgage may be created by depositing the title-deeds of a property with the mortgagee. No writing or registration is required, but the deposit must be made with the intention of creating a security and not for any other purpose. The transaction may be recorded in a letter or memorandum. A mortgage by deposit of title deeds is also called Equitable Mortgage.

6. Anomalous Mortgage. A mortgage which does not come within any of the above classes is called an Anomalous Mortgage. A mortgage containing a mixture of the characteristics of the different types mentioned above, comes within the category of anomalous mortgage.

Submortgage. The mortgagee can mortgage the interest transferred to him by way of security. Such a mortgage is called a Submortgage.

Subsequent Mortgages by the Mortgagor. After a property is mortgaged to a person, the owner can mortgage it again to other persons. The person to whom the property is mortgaged at first is called the first mortgagee. The next mortgagee is called second mortgagee and so on. There may be any number of mortgagees over the same property. For purposes of payment the different mortgagees rank in

order of time. The first mortgagee is paid in full first, then the second mortgagee and so on.

RIGHTS AND LIABILITIES OF MORTGAGORS AND MORTGAGEES

Apart from the provisions of the mortgage deed, the mortgagor and the mortgagee have certain statutory rights and liabilities. The important rights and liabilities are mentioned below.

Rights of Mortgagor:

1. **Redemption.** Any time after the principal amount secured by the mortgage becomes due, the mortgagor can get back the property by paying off the claims of the mortgagee. This right is called the Right of Redemption or the Equity of Redemption. This right is extinguished when the court so orders or when the court passes a decree for the sale of the mortgaged property. A decree of the court by which the mortgagor is prevented from exercising the right of redemption is called a *Decree for Foreclosure*. Such a decree may be passed in English mortgages.

The mortgage deed cannot impose any condition which prevents or restricts the right of redemption. Any clause in the deed which purports to do so is called a "clog on the right of redemption" and is void. When a transaction is in substance a mortgage, the court will not allow it to be converted into a sale or any other transaction. This principle is expressed in the maxim, "Once a mortgage, always a mortgage".

2. **Accessions.** If there is any accession (addition) to the property when the mortgagee is in possession, it goes to the mortgagor after the property is redeemed. The same rule applies to improvements made upon the property by the mortgagee, if any.

3. **Inspection and Copies.** The mortgagor is entitled to inspect and take copies of the title deeds of the property while they are in the possession of the mortgagee.

4. **Deposit and Suit.** The mortgagor can file a suit for redemption after the mortgage-money becomes due. He can also deposit the money due in court. Interest ceases to run after the mortgagee receives notice of the deposit.

5. **Instalments.** Where the transaction comes under the Money-lenders Act or any other similar statute, the court can direct the payment of money by instalments.

6. Lease. If the mortgagor is in possession, he can under certain circumstances grant a lease of the property.—Sec. 65A.

Rights of the Mortgagee:

1. He is entitled to incur expenditure for the protection and preservation of the property and is entitled to add such expenditure to the mortgage money. He has an insurable interest in the property.

2. He is entitled to receive the principal amount together with interest at the agreed rate, subject to the statutory provisions regarding the maximum payable rates of interest.

3. He can file a suit for the remedy appropriate to the type of mortgage entered into. The usual remedies are a suit for sale of the property and a suit for foreclosure.

4. Under certain circumstances the mortgagee can sell the mortgaged property without intervention of the court, *e.g.*, where such a right is given by the mortgage deed.

5. Section 65 of the Transfer of Property Act provides that, in the absence of a contract to the contrary, the mortgagor shall be deemed to have agreed to the following covenants :

(a) the mortgagor has title to the property and has the right to transfer the same ;

(b) there is right to quiet enjoyment of property ;

(c) the mortgagor will pay the public charges, rates and taxes due on the property ;

(d) if the mortgaged property is a lease, the rent due on it will be paid ; and

(e) the interest and principal due on prior encumbrances will be paid.

•
CHARGE

A charge on an immovable property is created when it is made liable for the payment of money to another, but the transaction does not amount to a mortgage.

Section 100 of the Transfer of Property Act defines a Charge as follows : "Where an immovable property of one person is, by an act of the parties or by operation of law, made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property."

Distinction between a charge and a mortgage.

1. In a mortgage, there is transfer of an interest in some immov-

able property. In a charge, there is no transfer of any interest to any person.

2. In some types of mortgage there is a personal covenant to pay by the mortgagor. There is no such covenant in a charge.

3. If a mortgaged property is transferred, the transferee takes the property subject to the mortgage, whether he was aware of the mortgage or not. But if a property subject to a charge is transferred to a *bona fide* transferee for value without notice, the transferee is not bound by the charge.

4. A mortgage can be created only by an act of parties. But a charge can be created by act of parties or by operation of law.

MORTGAGE AND PLEDGE

The difference between a mortgage and a pledge or pawn can be summed up as follows :

1. Mortgage relates to immovable property ; pledge or pawn to movable property.

2. In a mortgage there is transfer of an interest in some property ; in a pawn or pledge there is only an obligation to repay money.

3. Properties pawned or pledged remain with the creditor ; in a mortgage, possession of the property may be with the mortgagor or with the mortgagee.

4. The same property may be mortgaged several times ; there cannot be several pledges of the same goods.

EXERCISES

1. Describe Simple Mortgage and Equitable Mortgage. What are the requirements of an Equitable Mortgage ? (C. U. '60)

2. Define Mortgage. Distinguish between a mortgage and a charge on immovable property. (C. U. '61)

3. Write notes on Equitable Mortgage. (C. U. B.Com. '62).

CHAPTER 2

HYPOTHECATION

The term Hypothecation is used to describe a transaction whereby money is lent on the security of movable property but the property remains in the custody of the owner of the property. Hypothecation is also called mortgage of movables. Such transactions have been held to be valid in India although they are not dealt with in the Transfer of Property Act.

The owner of the goods which are hypothecated is called the Hypothecator. The person to whom the goods are hypothecated is called the Hypothecatee.

Hypothecation differs from mortgage on the following points: (i) Mortgage relates to immovable property; hypothecation to movable property. (ii) In a mortgage there is transfer of some interest in the property to the creditor; in hypothecation there is only an obligation to repay money, there is no transfer of any interest.

Hypothecation is similar to pawn or pledge because both deal with movable property. In a pawn or pledge, however, the creditor has possession of the property, while in hypothecation possession remains with the debtor.

The rights of the hypothecatee depend on the terms of the contract between the parties. He can file a suit to realise his dues by sale of the goods hypothecated. He may be given, by the terms of the contract, the right to sell the goods himself (on default of payment by the due date) and to realise his dues from the sale proceeds.

The hypothecatee may lose his rights, over the goods hypothecated, under the following circumstances:

1. If the hypothecator, in possession of the goods, sells them to a *bona fide* purchaser for value without notice of the hypothecation, the purchaser gets a good title to the goods and the hypothecatee cannot proceed against them. *Sreeman Narasiah v. Bansi Reddy Venkataramiah*.¹

2. If the hypothecator, in possession of the goods, makes a valid pledge of the goods and the pledgee has no notice of the hypothecation, the claims of the hypothecatee will be postponed to those of the pledgee. *Co-operative Hindusthan Bank v. Surendra*.²

¹ 42 Mad. 59

² A.I.R. (1932) Cal. 524

CHAPTER 3

LIEN

Lien may be defined as the right to retain goods belonging to another, till some claim is satisfied. There are three kinds of lien : (i) Possessory Lien (ii) Maritime Lien and (iii) Equitable Lien.

Possessory Lien. A possessory lien is one which can be exercised only by a person in possession of goods. A possessory lien may be a General Lien or a Particular Lien.

General Lien means the right to retain *all* the goods of another in the possession of a person until *all* the claims of the possessor are satisfied. General lien may be conferred by an agreement to that effect or by custom and usage or by the provisions of any statute. General lien exists in the case of solicitors, bankers, factors etc.

Particular Lien means the right to retain goods till some claim *concerning those goods* is paid. *Examples*: Common carriers can retain goods carried by them till the charge payable in respect of those goods are paid. Other bailees have similar rights.

A possessory lien can be enforced by retaining possession. The lien-holder cannot sell the property except under certain special circumstances.

A possessory lien is extinguished in the following cases : (i) when possession is lost (ii) when the money due is paid (iii) when the claimant takes some other security and thereby, by implication, abandons the right of lien and (iv) when the right of lien is waived.

Maritime Lien. Maritime lien is a right conferred by maritime law, specially binding a ship and her cargo, fittings and furniture, and freight for the payment of some claim. *Examples*: seamen for their wages; salvors for their reward; holders of a bottomry bond for the money lent, etc.

A maritime lien does not depend on possession. It can be exercised by persons not in possession by taking proceedings against the property concerned.

A maritime lien comes to an end by payment, release, waiver and by the destruction of the subject-matter of the lien.

Equitable Lien. An equitable lien means a lien which is conferred by law to enable a person to satisfy some claim over some other person's property. *Example* : an unpaid vendor of immovable property has a lien on the property for the unpaid purchase money.

An equitable lien is binding on all persons who take the property with notice of the lien. An equitable lien is enforced by a suit for the sale of the property. It is extinguished by payment of the claim and by transfer of the property to a *bona fide* purchaser for value without notice.

VOLUME TWO
INDUSTRIAL LAW

INDUSTRIAL LAW

CHAPTER 1

INTRODUCTION

DEFINITION AND SCOPE

The term Industrial Law is used to denote laws passed for the purpose of regulating the conditions under which work is carried on in factories and other establishments and the relationship between employers and employees.

Industrial legislation has a two-fold objective : (i) the preservation of the health, safety and welfare of workers, and (ii) the maintenance of good relations between employers and employees. All laws dealing with these matters come within the scope of Industrial Law.

THE NEED FOR INDUSTRIAL LEGISLATION

Industrial legislation is necessary for the following reasons.

1. Workers in factories, mines etc. are exposed to certain risks. For example, a worker may be injured by moving parts of machines if protective measures are not adopted. Therefore, laws are necessary for the health, safety and welfare of workers. It has been found that employers do not make adequate provisions for these things unless compelled to do so by law.

2. Legislation for the protection of labour is needed because the individual worker is economically weak and has little or no bargaining power. If the relationship between employers and employees is left to contract, the employers will always be able to impose harsh and oppressive terms (e.g., long hours and low wages).

3. Legislation is necessary to encourage and facilitate the formation of workers' associations or Trade Unions. Such associations increase the bargaining power of workers and provide the channel through which the grievances of labour can be made known. In the absence of legislative protection, trade unions have to face many difficulties.

4. Legislation is necessary for dealing with industrial disputes which frequently arise between employers and employees. Industrial disputes lead to strikes and lock-outs which are damaging not only to the parties involved but also to the economy of the country. Laws are needed for forcing the quick settlement of industrial disputes either through voluntary arbitration or through compulsory adjudication.

5. A branch of industrial legislation which is receiving increasing attention in modern times is Social Insurance. Owing to their low level of earnings, workers find themselves in great difficulty when faced with sickness, accident, unemployment and old age. Government action is needed for providing some measure of security against these risks. This can be done through appropriate legislative measures.

A CLASSIFICATION OF INDIAN INDUSTRIAL LAW

Indian Industrial Law can be classified under the following headings :

I. Laws regulating conditions of work in factories and establishments. There are two types of such laws :

(a) General laws applicable to all establishments not otherwise provided for. *Examples*—the Factories Act of 1948 and the Industrial Standing Orders Act of 1946.

(b) Specific laws applicable to particular industries. *Examples*—the Indian Mines Act of 1952, the Plantations Labour Act of 1951, the Dock Workers [Regulation of Employment] Act of 1948 etc.

II. Laws relating to associations of workers, *e.g.*, the Trade Unions Act of 1926.

III. Laws relating to industrial disputes, *e.g.*, the Industrial Disputes Act of 1947.

IV. Laws relating to wages and emoluments *e.g.*, the Payment of Wages Act of 1936, the Minimum Wages Act of 1948, the Provident Funds Act of 1952 etc.

V. Laws relating to Social Insurance *i.e.*, laws which provide security against risks like accident, maternity etc. *Examples*—the Workmen's Compensation Act of 1923, the Maternity Benefit Acts of the different States, the Employees' State Insurance Act of 1948.

CHAPTER 2

THE FACTORIES ACT

INTRODUCTION

The object of the Factories Act is to regulate the conditions of work in manufacturing establishments coming within the definition of the term "factory" as used in the Act.

The first Act, in India, relating to the subject was passed in 1881. This was followed by new Acts in 1891, 1911, 1922, 1934 and 1948. The Act of 1948 is the latest Act. It is more comprehensive than the previous Acts. It contains detailed provisions regarding the health, safety and welfare of workers inside factories, the hours of work, the minimum age of workers, leave with pay etc. The Act has been amended several times after 1948.

The Factories Act of 1948 came into force on 1st April 1949. It applies to factories, as defined in the Act, all over India except the State of Jammu and Kashmir.

Unless otherwise provided, the Factories Act applies to factories belonging to the Central or any State Government.—Sec. 116.

The Act is based more or less on the provisions of the Factories Act of Great Britain passed in 1937.

WHAT IS A FACTORY ?

The term Factory is defined in Section 2 (m) of the Act as follows : "Factory means any premises including the precincts thereof—

- (i) whereon ten or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is 'being carried on with the aid of power or is ordinarily so carried on, or
- (ii) whereon twenty or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on,—but does not include a mine subject to the operation of the Indian Mines Act, 1952 (Act XXXV of 1952), or a railway running shed."

From the above it follows that an establishment comes within the definition of a Factory if the conditions stated below are satisfied :

1. It is a place where a "manufacturing process" is carried on.
2. It employs the prescribed minimum number of "workers" viz., ten if "power" is used, and twenty if no "power" is used. It is sufficient if the prescribed number of workers were employed on any day of the preceding twelve months.

3. It is not a mine coming within the purview of the Indian Mines Act of 1952 or a railway running shed.

To clarify the meaning of the term Factory, it is necessary to explain three other terms, viz., "manufacturing process", "worker" and "power".

Manufacturing Process. This term is defined in Section 2(k) in a very wide sense. It includes making, altering, repairing etc. any article or substance with a view to its use, sale, transport, delivery or disposal ; pumping oil, water or sewage ; printing, lithography etc. ; constructing, repairing ships and vessels etc. For the corresponding section of the English Act, it was held that the different processes enumerated in the clauses are merely illustrative, so that laundries, carpet beating, or bottle washing works come within the Act, if mechanical power is used. *Patterson v. Hunt*.¹

Worker. "Worker means a person employed, directly or through any agency, whether for wages or not, in any manufacturing process, or in cleaning any part of the machinery or premises used for a manufacturing process, or in any other kind of work incidental to, or connected with, the manufacturing process, or the subject of the manufacturing process." Sec. 2 (1).

Worker means any person engaged in any work connected with or incidental to a manufacturing process. Thus the definition is wide. The term includes persons engaged directly and also those who are engaged through an agency. The term includes clerical workers and persons paid by piece rates in a factory.

Examples :

- (i) Mere selling agents though occupying a room in the factory are not workers within the meaning of the Act. *Prag Narayan v. Crown*.² But persons selling manufactured articles in the factory premises are workers. *Local Government v. Nusarwanji*.³

¹ (1909) 73 J.P. 496

² (1928) Lah 78

³ (1933) Nag 283

- (ii) Apprentices, whether remunerated or not, are workers within the meaning of the Act.
- (iii) A technical institute, where pupils are trained in wood work, is not a factory because there is no relationship of employer and employed between the organisers and the pupils. *Weston v. London County Council*.⁴

Power. "Power means electrical energy, or any other form of energy which is mechanically transmitted and is not generated by human or animal agency." Sec. 2 (g).

Under Section 85, the State Government is empowered to declare any establishment carrying on a manufacturing process to be a factory for the purposes of the Act even though it employs less than the prescribed minimum number of workers, provided that the manufacturing process is not being carried on by the owner only with the aid of his family.

DEFINITIONS

Adult. "Adult means a person who has completed his eighteenth year of age." Sec. 2 (a).

Adolescent. "Adolescent means a person who has completed his fifteenth year of age but has not completed his eighteenth year." Sec. 2 (b).

Child. "Child means a person who has not completed his fifteenth year of age." Sec. 2 (c).

Young Person. "Young Person means a person who is either a child or an adolescent." Sec. 2 (d).

Calendar Year. "Calendar Year means the period of twelve months beginning with the first day of January in any year." Sec. 2 (bb).

Day. "Day means a period of twentyfour hours beginning at midnight." Sec. 2 (e). References to the time of the day in the Act are to the Indian Standard Time. In areas where the I.S.T. is not observed, the State Government can by rules define the local mean time. Sec. 3.

Week. "Week means a period of seven days beginning at midnight on Saturday night or such other night as may be approved in writing for a particular area by the Chief Inspector of Factories." Sec. 2 (f).

Shift and Relay. Where work of the same kind is carried out by two or more sets of workers working during different periods of

⁴ (1941) 1 K.B. 608

the day, each of such sets is called a "relay" and each of such periods is called a "shift."

Occupier. "Occupier" of a factory means the person who has ultimate control over the affairs of the factory, and where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory. Sec. 2 (n).

The Act imposes several duties and responsibilities on the occupier of the factory.

APPROVAL, LICENCING AND REGISTRATION

It is necessary to obtain a licence before a factory is started. Section 6 empowers the State Government to make rules for the following purposes :

- (a) requiring the previous permission in writing of the State Government or the Chief Inspector to be obtained for the site on which the factory is to be situated and for the construction or extension of any factory or class or description of factories ;
- (b) the submission of plans and specifications for the above purpose ;
- (c) prescribing the nature of such plans and specifications and by whom they shall be certified ;
- (d) requiring the registration and licencing of factories or any class or description of factories and the fees to be paid for that purpose ;
- (e) requiring the submission of a notice by the occupier before a factory commences work or resumes work.

If permission for the site or construction or extension or licensing or registration is refused, an appeal may be preferred within 30 days of the refusal. If the order appealed from is that of a State Government, the appeal lies to the Central Government ; in all other cases the appeal lies to the State Government.

Rules have been framed by the State Governments under this section. Rules regarding the plans and specifications of a factory are needed to ensure proper ventilation, sanitation and other health measures. Control over the site of a factory is necessary to avoid congestion in towns.

Section 7 provides that the occupier of a factory must, at least 15 days before he begins to occupy or use any premises as a factory, send to the Chief Inspector of Factories a written notice containing particulars like name and address of the factory and of the occupier,

the nature of the manufacturing process, the number of workers likely to be appointed etc.

THE INSPECTING STAFF

The Factories Act empowers the State Governments to appoint Inspectors and Chief Inspectors of Factories for the purpose of enforcing the provisions of the Act. Every District Magistrate is an Inspector for his district. No person can act as an Inspector if he is or becomes directly or indirectly interested in a factory, or in any process or business carried on therein or in any patent or machinery connected therewith.

Powers of Inspectors. Section 9 provides that subject to any rules made in this behalf, an Inspector may exercise the following powers within the local limits for which he is appointed :—

- (a) enter, with such assistants, being persons in the service of the Government or any local or other public authority, as he thinks fit, any place which is used, or which he has reason to believe is used, as a factory ;
- (b) make examination of the premises, plant and machinery, require the production of any prescribed register and any other document relating to the factory, and take on the spot or otherwise statements of any person which he may consider necessary for carrying out the purposes of the Act ;
- (c) exercise such other powers as may be prescribed for carrying out the purposes of this Act ;

Provided that no person shall be compelled under this section to answer any question or give any evidence tending to incriminate himself.

Under Section 91, an Inspector may take a sample of any substance, used or intended to be used in a factory, for the purpose of finding out whether the substance is injurious and if the factory is violating any of the provisions of the Act.

Certifying Surgeons. Section 10 provides that the State Government may appoint qualified medical practitioners to be certifying surgeons for the purposes of the Act for specified local areas or for specified factories or class of factories.

The certifying surgeon has certain duties prescribed by the Act and the rules framed under it, *e.g.*, the examination and certification of young persons ; the examination of persons engaged in factories in dangerous occupations or processes ; medical supervision of factories in cases where such supervision has been prescribed owing to the dangerous nature of the work carried on or for any other reason.

No person can be a certifying surgeon for a factory or industry in which he is interested directly or indirectly. \

PROVISIONS REGARDING THE HEALTH OF WORKERS

Sections 11 to 20 of the Act contain certain provisions intended to ensure that the conditions under which work is carried on in factories do not affect the health of the workers injuriously. The provisions are summarised below.

1. **Cleanliness.** (Sec. 11) Every factory shall be kept clean and free from effluvia arising from any drain, privy or other nuisance. The following other measures must also be adopted :

- (a) Accumulations of dirt and refuse shall be removed daily from workrooms, staircases and passages.
- (b) The floor of every workroom shall be cleaned at least once in every week by washing, using disinfectants etc.
- (c) Where the floor is liable to get wet, means of drainage must be provided.
- (d) All inside walls and partitions and ceilings must be repainted or revarnished at least once in every five years. Where they have smooth impervious surfaces, they must be cleaned at least once in fourteen months. In any other case, they must be whitewashed or colour-washed at least once in fourteen months.

Where the nature of the operations of a factory is such that all the aforesaid rules cannot be complied with, the State Government can grant exemptions and specify alternative methods of keeping the factory clean.

2. **Disposal of wastes and effluents.** (Sec. 12) Effective arrangements shall be made in every factory for the disposal of wastes and effluents due to the manufacturing process carried on therein. The arrangements must be approved by the authority under the rules.

3. **Ventilation and temperature.** (Sec. 13) Effective and suitable provision shall be made in every factory for securing and maintaining in every workroom—

- (a) adequate ventilation by the circulation of fresh air, and
- (b) a temperature which will secure comfort and prevent injury to health.

The walls and the roof must be of such material and of such design as to keep the temperature low. The hot parts of machines and processes must be separated and insulated. The State Government may make rules providing for the keeping of thermometers in

specified places and the adoption of methods which will keep the temperature low.

4. **Dust and fume.** (Sec. 14) If the manufacturing process gives off dust or fume which is injurious or offensive, measures shall be adopted to prevent its inhalation and accumulation. If a stationary internal combustion engine is used, steps must be taken to conduct its exhaust outside. In other cases, steps must be taken to prevent the accumulation of the exhaust fumes.

5. **Artificial humidification.** (Sec. 15) In respect of all factories in which the humidity of the air is artificially increased, the State Government may make rules regarding the following: (a) the standards of humidification, (b) the methods used for artificially increasing humidity, (c) tests for determining the humidity, and (d) the methods to be adopted for securing adequate ventilation and cooling of the air in the workrooms.

The water used for humidification shall be taken from a public supply or other source of drinking water and must be effectively purified before use. The Inspector of factories may, if necessary, specify the measures necessary for purifying the water.

6. **Overcrowding.** (Sec. 16) No room in any factory shall be overcrowded to an extent injurious to the health of the workers. In factories existing before the commencement of the Act, there must be at least 350 c.ft. of space for every worker employed therein. In factories built after the Act, there must be at least 500 c.ft. of space per worker. In calculating the amount of space, no account shall be taken of any space which is more than 14 ft. above the floor of the room. If the Chief Inspector so requires, there shall be posted in every room a notice specifying the maximum number of workers who may be employed in the room in accordance with the above rules. The Chief Inspector may, by order in writing, exempt a workroom from the operation of the above rules if in his opinion it is unnecessary in the interest of health.

7. **Lighting.** (Sec. 17) In every part of a factory where workers are working or passing there shall be provided and maintained sufficient and suitable lighting, natural or artificial or both. Glazed windows and skylights shall be kept clean on both sides and free from obstruction. Effective provision shall be made, so far as is practicable, to prevent glare and the formation of shadows to such an extent as to cause eyestrain or the risk of accident. The State Government may prescribe standards of suitable lighting.

8. **Drinking water.** (Sec. 18) In every factory effective arrangements shall be made to provide and maintain at suitable points

conveniently situated for all workers employed therein a sufficient supply of wholesome drinking water. All such points shall be legibly marked "drinking water" in the language understood by the majority of the workers. No such points shall be situated within 20 ft. of any washing place, urinal or latrine, unless a shorter distance is approved in writing by the Chief Inspector. In every factory wherein more than 250 workers are ordinarily employed, provision shall be made for cooling drinking water during hot weather by effective means and for distribution thereof. The State Governments may make rules regarding the above provisions.

9. Latrines and Urinals. (Sec. 19) In every factory sufficient latrine and urinal accommodation of prescribed types shall be provided conveniently situated and accessible to workers at all times while they are at the factory. Separate enclosed accommodation shall be provided for male and female workers. Such accommodation shall be adequately lighted and ventilated. No latrine or urinal shall, unless specially exempted in writing by the Chief Inspector, communicate with any workroom except through an intervening open space or ventilated passage. All such accommodation shall be maintained in a clean and sanitary condition at all times. Sweepers shall be appointed whose primary duty it would be to keep clean latrines, urinals and washing places.

Certain additional measures are to be taken in factories where more than 250 workers are ordinarily employed. The latrines and urinals shall be of the prescribed sanitary types. The floors, internal walls up to the height of 3 ft. and the sanitary blocks shall be laid in glazed tiles or otherwise finished to provide a smooth polished impervious surface. These parts and the sanitary pans shall be thoroughly washed and cleaned at least once every 7 days with suitable detergents or disinfectants or both. The State Government may prescribe the number of latrines and urinals to be provided in proportion to the number of workers. Other rules regarding sanitation may be made, including the obligations of the workers in this regard.

10. Spittoons. (Sec. 20) A sufficient number of spittoons must be provided at convenient places. They must be maintained in a clean and hygienic condition. The State Government may make rules regarding their number, location and maintenance. No person shall spit except in the spittoons. If a person does so he may be fined up to Rs. 5.

PROVISIONS REGARDING THE SAFETY OF WORKERS

Sections 21 to 41 of the Act lay down rules for the purpose of securing the safety of workers. They are summarised below.

Fencing of machinery. (Sec. 12) The following machinery must be securely fenced by safeguards of substantial construction which shall be kept in position while the parts of machinery are in motion or in use : moving parts of prime movers and flywheels connected to a prime mover ; the headrace and tailrace of every water-wheel and water turbine ; any part of a stock-bar which projects beyond the head stock of a lathe. The following machinery must be fenced in a similar fashion unless they are in such position or of such construction as to be safe : every part of an electric generator, a motor or rotary converter ; every part of transmission machinery ; and, every dangerous part of any other machinery. The State Government may by rules provide for further precautions. It may also exempt any particular machinery or part thereof from the provisions of this section.

2. Work on or near machinery in motion. (Sec. 22) It may be necessary in a factory to examine a machine while in motion and to work on it (*e.g.* for shipping of belts or for lubrication). Such examination or work must be carried out by a specially trained adult male worker wearing tightly fitting clothes whose name has been recorded in a specially prescribed register. While the worker is so engaged he shall not handle a belt at a moving pulley unless the belt is less than six inches in width and unless the belt-joint is either laced or flush with the belt. Every screw, bolt etc with which such worker is liable to come into contact must be securely fenced to prevent such contact. No woman or young person shall be allowed to clean, lubricate or adjust any part of the machinery while the prime mover or transmission machinery is in motion or to work between moving parts, or between fixed and moving parts, of any machinery which is in motion. The State Government may prohibit in any specified factory or class or description of factory, the cleaning, lubrication or adjustment of specified parts of a moving machinery by any person.

3. Employment of young persons on dangerous machines. (Sec. 23) No young person shall work at any dangerous machine unless he has been fully instructed as to the dangers arising in connection with the machine and the precautions to be observed, and (a) has received sufficient training in work at the machine or (b) is under adequate supervision by a person who has a thorough knowledge and experience of the machine. The State Government is to prescribe what machines are dangerous for the purpose of this section.

4. Striking gear and devices for cutting off power. (Sec. 24) In every factory suitable striking gear or other efficient mechanical appliances shall be provided and maintained and used to move driving belts to and from fast and loose pulleys which form part of the

transmission machinery. Such gear or appliances shall be so constructed, placed and maintained as to prevent the belt from creeping back on to the fast pulley. Driving belts when not in use shall not be allowed to rest or ride upon shafting motion. In every factory suitable devices for cutting off power in emergencies from running machinery shall be provided and maintained in every workroom. For factories which were in operation before the commencement of the Act, the maintenance of devices for cutting off power is required only for work rooms in which electricity is used for power.

5. Self-acting machines. (Sec. 25) No traversing part of a self-acting machine in any factory and no material carried thereon shall, if the space over which it runs is a space over which any person is liable to pass, whether in the course of his employment or otherwise, be allowed to run on its outward or inward traverse within a distance of eighteen inches from any fixed structure which is not part of the machine.

The Chief Inspector may permit the continued use of a machine, not complying with the above requirement, if it was installed before the commencement of the Act. He may, however, impose conditions for ensuring safety.

6. Casing of new machinery. (Sec. 26) In all machinery installed after the commencement of the Act,

- (a) every set screw, bolt or key, on any revolving shaft, spindle, wheel or pinion shall be so sunk, encased or otherwise effectively guarded as to prevent danger ;
- (b) all spur, worm and other toothed or friction gearing which does not require frequent adjustment while in motion shall be completely encased unless it is so situated that it is safe without encasement.

The State Government may make rules specifying further safeguards.

It is a punishable offence to sell or let out on hire, either directly or as an agent, any machine which does not comply with the provisions of this section or of any rules made by the State Government on the subject. (The offender may be punished with imprisonment up to three months and/or fined up to Rs. 500).

7. Women and children near cotton-openers. (Sec. 27) No woman or child shall be employed in any part of a factory for pressing cotton in which a cotton-opener is at work.

If the feed-end of a cotton-opener is in a room separated from the delivery-end by a partition extending to the roof or to such height

as the Inspector may in a particular case specify in writing, women and children may be employed on the side of the partition where the feed-end is situated.

8. Hoists and lifts. (Sec. 28) (1) In every factory—

- (a) every hoist and lift shall be—
 - (i) of good mechanical construction, sound material and adequate strength ;
 - (ii) properly maintained, and shall be thoroughly examined by a competent person at least once in every period of six months, and a register shall be kept containing the prescribed particulars of every such examination ;
- (b) every hoistway and liftway shall be sufficiently protected by an enclosure fitted with gates, and the hoist or lift, and every such enclosure shall be so constructed as to prevent any person or thing from being trapped between any part of the hoist or lift and any fixed structure or moving part ;
- (c) the maximum safe working load shall be plainly marked on every hoist or lift, and no load greater than such load shall be carried thereon ;
- (d) the cage of every hoist or lift used for carrying persons shall be fitted with a gate on each side from which access is afforded to a landing ;
- (e) every gate referred to in clause (b) or clause (d) shall be fitted with interlocking or other efficient device to secure that the gate cannot be opened except when the cage is at the landing and that the cage cannot be moved unless the gate is closed.

(2) The following additional requirements shall apply to hoists and lifts used for carrying persons and installed or reconstructed in a factory after the commencement of this Act, namely :—

- (a) where the cage is supported by rope or chain, there shall be at least two ropes or chains separately connected with the cage and balance weight, and each rope or chain with its attachments shall be capable of carrying the whole weight of the cage together with its maximum load ;
- (b) efficient devices shall be provided and maintained capable of supporting the cage together with its maximum load in the event of breakage of the ropes, chains or attachments ;
- (c) an efficient automatic device shall be provided and maintained to prevent the cage from over-running.

(3) The Chief Inspector may permit the continued use of a hoist or lift installed in a factory before the commencement of this Act which does not fully comply with the provisions of sub-section (1) upon such conditions for ensuring safety as he may think fit to impose.

(4) The State Government may, if in respect of any class or description of hoist or lift, it is of opinion that it would be unreasonable to enforce any requirement of sub-section (1) and (2), by order direct that such requirement shall not apply to such class or description of hoist or lift.

9. Lifting machines, chains, ropes and lifting tackles. (Sec. 29) In any factory the following provisions shall be complied with in respect of every lifting machine (other than a hoist and lift) and every chain, rope and lifting tackle for the purpose of raising or lowering persons, goods or materials :—

(a) all parts, including the working gear, whether fixed or movable, or every lifting machine and every chain, rope or lifting tackle shall be—

(i) of good construction, sound material and adequate strength and free from defects ;

(ii) properly maintained ; and

(iii) thoroughly examined by a competent person at least once in every period of twelve months, or at such intervals as the Chief Inspector may specify in writing, and a register shall be kept containing the prescribed particulars of every such examination ;

(b) no lifting machine and no chain, rope or lifting tackle shall, except for the purpose of test, be loaded beyond the safe, working load which shall be plainly marked thereon together with an identification mark and duly entered in the prescribed register ; and where this is not practicable, a table showing the safe working loads of every kind and size of lifting machine or chain, rope or lifting tackle in use shall be displayed in prominent positions on the premises ;

(c) while any person is employed or working on or near the wheel track of a travelling crane in any place where he would be liable to be struck by the crane, effective measures shall be taken to ensure that the crane does not approach within twenty feet of that place.

The State Government may by rules prescribe further requirements or exempt from compliance any of the requirements if it considers it unnecessary or impracticable.

10. Revolving machinery. (Sec. 30) (1) In every room in a factory in which the process of grinding is carried on there shall be permanently affixed to or placed near each machine in use a notice indicating the maximum safe working peripheral speed of every grindstone or abrasive wheel, the speed of the shaft or spindle upon which the wheel is mounted and the diameter of the pulley upon such shaft or spindle necessary to secure such safe working peripheral speed.

(2) The speed indicated as above must not be exceeded.

(3) Effective measures shall be taken to ensure that the safe working peripheral speed of every revolving vessel, cage etc. driven by power is not exceeded.

11. Pressure plant. (Sec. 31) If in any factory any operation is carried on at a pressure above atmospheric pressure, effective measures shall be taken to ensure that the safe working pressure is not exceeded. The State Government may make rules for the examination and testing of machinery and prescribe safety measures.

12. Floors, stairs, and means of access. (Sec. 32) In every factory all floors, steps, stairs, passages and gangways shall be of sound construction and properly maintained. Where it is necessary to ensure safety they shall be provided with substantial handrails. Safe means of access must be provided and maintained to every place at which any person is at any time required to work.

13. Pits, sumps, openings in floors etc. (Sec. 33) Every fixed vessel, sump, tank, pit or opening in the ground or in a floor which by reason of its depth, situation, construction or contents is or may be a source of danger, shall be either securely covered or securely fenced. The State Government may exempt compliance in any particular case.

14. Excessive weights. (Sec. 34) (1) No person shall be employed in any factory to carry or move any load so heavy as to be likely to cause him injury.

(2) The State Government may make rules prescribing the maximum weights which may be lifted, carried or moved by adult men, adult women, adolescents and children employed in factories or in any class or description of factories or in carrying on any specified process.

15. Protection of eyes. (Sec. 35) In respect of any such manufacturing process carried on in any factory as may be prescribed, being a process which involves—

- (a) risk of injury to the eyes from particles or fragments thrown off in the course of the process, or
- (b) risk to the eyes by reason of excessive light,—

the State Government may by rules require that effective screen or suitable goggles shall be provided for the protection of persons employed on, or in the immediate vicinity of, the process.

✓16. **Precautions against dangerous fumes.** (Sec. 36) (1) In any factory no person shall enter or be permitted to enter any chamber, tank, vat, pit, pipe, flue or other confined space in which dangerous fumes are likely to be present to such an extent as to involve risk of persons being overcome thereby, unless it is provided with a manhole of adequate size or other effective means of egress.

(2) No portable electric light of voltage exceeding twenty-four volts shall be permitted in any factory for use inside any confined space such as is referred to in sub-section (1), and where the fumes present are likely to be inflammable, no lamp or light other than of flameproof construction shall be permitted to be used in such confined space.

(3) No person in any factory shall enter or be permitted to enter any confined space such as is referred to in sub-section (1) until all practicable measures have been taken to remove any fumes which may be present and to prevent any ingress of fumes and unless either—

(a) a certificate in writing has been given by a competent person, based on a test carried out by himself that the space is free from dangerous fumes and fit for persons to enter, or

(b) the worker is wearing suitable breathing apparatus and a belt securely attached to a rope, the free end of which is held by a person standing outside the confined space.

(4) Suitable breathing apparatus, reviving apparatus and belt and ropes shall in every factory be kept ready for instant use beside any such confined space as aforesaid which any person has entered, and all such apparatus shall be periodically examined and certified by a competent person to be fit for use; and a sufficient number of persons employed in every factory shall be trained and practised in the use of all such apparatus and in the method of restoring respiration.

(5) No person shall be permitted to enter in any factory any boiler furnace, boiler flue, chamber tank, vat, pipe or other confined space for the purpose of working or making any examination therein until it has been sufficiently cooled by ventilation or otherwise to be safe for persons to enter.

(6) The State Government may make rules prescribing the minimum dimensions of manholes and may also grant exemptions in particular cases.

17. Explosive or inflammable gas etc. (Sec. 37) (1) Where in any factory any manufacturing process produces dust, gas, fume or vapour of such character and to such extent as to be likely to explode on ignition, all practicable measures shall be taken to prevent any such explosion by—

- (a) effective enclosure of the plant or machinery used in the process;
- (b) removal or prevention of the accumulation of such dust, gas, fume or vapour;
- (c) exclusion or effective enclosure of all possible sources of ignition.

(2) Where the plant is not so constructed as to withstand the probable pressure which an explosion would produce, all practicable measures shall be taken to restrict the spread and effects of the explosion by providing chokes, baffles, vents or other effective appliances.

(3) Where any part of a plant or machinery contains explosive or inflammable gas or vapour at a pressure greater than the atmospheric pressure, the part shall not be opened except under the following conditions:

- (a) the flow of gas or vapour must be effectively stopped by a stop valve or other means;
- (b) all practicable measures must be taken to reduce the pressure to the atmospheric pressure; and
- (c) where the fastening of such part has been loosened or removed, the fastening must be secured or securely replaced.

The aforesaid provisions do not apply to plant or machinery installed in open air.

(4) The container of explosive or inflammable substances shall not be subjected to any operation which involves the application of heat unless adequate measures have been adopted to remove the substance or its fumes or to render the substance or fumes non-explosive or non-inflammable. The substance shall be allowed to re-enter the container only after the latter has been sufficiently cooled.

(5) The State Government may by rules allow exemptions from the provisions of this section.

18. Precaution in case of fire. (Sec. 38) (1) Every factory shall be provided with such means of escape in case of fire as may be prescribed. If it appears to the Inspector that any factory is not so provided, he may serve on the manager an order in writing specifying the measures to be adopted.

(2) In every factory, the doors affording exit from any room shall not be locked or fastened so that they cannot be easily and immediately opened from the inside while any person is within the room, and all such doors, unless they are of the sliding type, shall be constructed to open outward.

(3) In every factory, every window, door or other exit affording a means of escape in case of fire, other than the means of exit in ordinary use, shall be distinctively marked in a language understood by the majority of the workers and in red letters of adequate size or by some other effective and clearly understood sign.

(4) There shall be provided in every factory effective clearly audible means of giving warning in case of fire to every person employed in the factory.

(5) A free passage-way giving access to each means of escape in case of fire shall be maintained for the use of all workers in every room of a factory.

(6) Effective measures shall be taken to ensure that in every factory—

- (a) wherein more than twenty workers are ordinarily employed in any place above the ground floor, or
- (b) wherein explosive or highly inflammable materials are used or stored, all the workers are familiar with the means of escape in case of fire and have been adequately trained in the routine to be followed in such case.

(7) The State Government may make rules prescribing, in respect of any factory or class or description of factories, the means of escape to be provided in case of fire and the nature and amount of fire-fighting apparatus to be provided and maintained

19. Power to require specifications of defective parts or tests of stability. (Sec. 39) If it appears to the Inspector that any building or part of a building or any part of the ways, machinery or plant in a factory is in such a condition that it may be dangerous to human life or safety, he may serve on the manager of the factory an order in writing requiring him before a specified date—

- (a) to furnish such drawings, specifications and other particulars as may be necessary to determine whether such building, ways, machinery or plant can be used with safety, or
- (b) to carry out such tests in such manner as may be specified

in the order, and to inform the Inspector of the results thereof.

20. Safety of buildings and machinery. (Sec. 40) (1) If it appears to the Inspector that any building or part of a building or any part of the ways, machinery or plant in a factory is in such a condition that it is dangerous to human life or safety, he may serve on the manager of the factory an order in writing specifying the measures which in his opinion should be adopted, and requiring them to be carried out before a specified date.

(2) If it appears to the Inspector that the use of any building or part of a building or any part of the ways, machinery or plant in a factory involves imminent danger to human life or safety, he may serve on the manager of the factory an order in writing prohibiting its use until it has been properly repaired or altered.

21. Power to make rules to supplement this Chapter. (Sec. 41) The State Government may make rules providing for the use of such further devices for safety as may be necessary.

PROVISIONS REGARDING THE WELFARE OF WORKERS ✓

Sections 42 to 50 of the Act contain certain provisions regarding the welfare of workers. They are summarised below.

1. Washing facilities. (Sec. 42) In every factory—

- (a) adequate and suitable facilities for washing shall be provided and maintained for the use of the workers therein ;
- (b) separate and adequately screened facilities shall be provided for the use of male and female workers ;
- (c) such facilities shall be conveniently accessible and shall be kept clean. The State Government may make rules prescribing adequate standards of facilities for washing.

2. Facilities for storing and drying clothing. (Sec. 43) The State Government may make rules requiring the provision of suitable places for keeping clothing not worn during working hours and for the drying of wet clothing.

3. Facilities for sitting. (Sec. 44) (1) In every factory suitable arrangements for sitting shall be provided and maintained for all workers obliged to work in a standing position, in order that they may take advantage of any opportunity for rest which may occur in course of work.

(2) If in the opinion of the Chief Inspector workers in a parti-

cular room are able to do their work efficiently in a sitting position, he may by an order in writing direct the occupier of the factory to provide sitting arrangements before a specified date.

(3) The State Government may by notification in the official Gazette direct that the aforesaid provisions shall not apply to specified cases.

4. First-aid appliances. (Sec. 45) (1) First-aid boxes or cupboards equipped with the prescribed contents must be provided in every factory. They must be readily accessible during working hours. The number of such boxes shall not be less than one for every 150 workers employed.

(2) The boxes or cupboards must not contain anything other than the prescribed contents.

(3) Each box or cupboard shall be kept in charge of a separate responsible person who is trained in first-aid treatment and who shall always be readily available during the working hours.

(4) In every factory wherein more than 500 workers are employed there shall be provided and maintained an ambulance room of the prescribed size, containing the prescribed equipment and in the charge of such medical and nursing staff as may be prescribed.

5. Canteens. (Sec. 46) (1) The State Government may make rules requiring that in any specified factory wherein more than two hundred and fifty workers are ordinarily employed, a canteen or canteens shall be provided and maintained by the occupier for the use of the workers.

(2) Without prejudice to the generality of the foregoing power, such rules may provide for—

- (a) the date by which such canteen shall be provided ;
- (b) the standards in respect of construction, accommodation, furniture and other equipment of the canteen ;
- (c) the foodstuffs to be served therein and the charges which may be made therefor ;
- (d) the constitution of a managing committee for the canteen and representation of the workers in the management of the canteen ;
- (e) the delegation to the Chief Inspector, subject to such conditions as may be prescribed, of the power to make rules under clause (c).

6. Shelters, rest rooms and lunch rooms. (Sec. 47) (1) In every factory wherein more than one hundred and fifty workers are ordi-

narily employed, adequate and suitable shelters or rest rooms and a suitable lunch room, with provision for drinking water, where workers can eat meals brought by them, shall be provided and maintained for the use of the workers :

Provided that any canteen maintained in accordance with the provisions of section 46 shall be regarded as part of the requirements of this sub-section :

Provided further that where a lunch room exists no worker shall eat any food in the work room.

(2) The shelters or rest rooms or lunch rooms to be provided under sub-section (1) shall be sufficiently lighted and ventilated and shall be maintained in a cool and clean condition.

(3) The State Government may—

(a) prescribe the standards in respect of construction, accommodation, furniture and other equipment of shelters, rest rooms and lunch rooms to be provided under this section ;

(b) by notification in the official Gazette, exempt any factory or class or description of factories from the requirements of this section.

7. Creches. (Sec. 48) (1) In every factory wherein more than fifty women workers are ordinarily employed there shall be provided and maintained a suitable room or rooms for the use of children under the age of six years of such women.

(2) Such rooms shall provide adequate accommodation, shall be adequately lighted and ventilated, shall be maintained in a clean and sanitary condition and shall be under the charge of women trained in the care of children and infants.

(3) The Government may make rules—

(a) prescribing the location and the standards in respect of construction, accommodation, furniture and other equipment of rooms to be provided under this section ;

(b) requiring the provision in factories to which this section applies of additional facilities for the care of children belonging to women workers, including suitable provision of facilities for washing and changing their clothing ;

(c) requiring the provision in the factory of free milk or refreshment or both for such children ;

(d) requiring that facilities shall be given in any factory for the mothers of such children to feed them at the necessary intervals.

8. Welfare officers. (Sec. 49) (1) In every factory wherein

five hundred or more workers are ordinarily employed the occupier shall employ in the factory such number of welfare officers as may be prescribed.

(2) The State Government may prescribe the duties, qualifications and conditions of service of officers employed under subsection (1).

9. Power to make rules to supplement this Chapter. (Sec. 50) The State Government may make rules—

- (a) exempting, subject to compliance with such alternative arrangements for the welfare of workers as may be prescribed, any factory or class or description of factories from compliance with any of the provisions of this Chapter ;
- (b) requiring in any factory or class or description of factories that representatives of the workers employed in the factory shall be associated with the management of the welfare arrangements of the workers.

THE WORKING HOURS OF ADULTS

Weekly Hours : No adult worker shall be required or allowed to work in a factory for more than forty-eight hours in any week. Sec. 51.

Daily Hours : No adult worker shall be required or allowed to work in a factory for more than nine hours in any working day. The daily maximum may be exceeded with the previous approval of the Chief Inspector, to facilitate change of shifts. Sec. 54.

Intervals for Rest : The periods of work of adult workers in a factory each day shall be so fixed that no period shall exceed five hours and that no worker shall work for more than five hours before he has had an interval for rest of at least half an hour. The State Government or the Chief Inspector may, by order in writing, and for reasons stated therein, increase the work period to six. Sec. 55.

Spreadover : The periods of work of an adult worker in a factory shall be so arranged that inclusive of his intervals for rest under section 55, they shall not spread-over more than ten and half hours in any day. The Chief Inspector may for specified reasons increase the spreadover to twelve hours. Sec. 56.

OTHER PROVISIONS REGARDING EMPLOYMENT OF ADULTS

Night Shifts : Where a worker in a factory works on a shift which extends beyond midnight, (a) his weekly holiday and compen-

satory holiday means a period of holiday for 24 consecutive hours beginning when his shift ends, and (b) the following day for him shall be deemed to be the period of 24 hours beginning when such shift ends and the hours he has worked after midnight shall be counted in the previous day. Sec. 57.

Overlapping Shifts : Work shall not be carried on in any factory by means of a system of shifts so arranged that more than one relay of workers is engaged in work of the same kind at the same time. The State Government or the Chief Inspector may grant exemption from this rule. Sec. 58.

Extra Wages for Overtime : Where a worker works in a factory for more than nine hours in any day or for more than 48 hours in any week, he shall in respect of overtime work, be entitled to wages at the rate of twice his ordinary rate of wages.

Where wages are paid on a piece-rate basis, the State Government, in consultation with the employer concerned and the representatives of the workers, shall fix the time rate as nearly as possible equivalent to the average rate of earnings of those workers and the rates so fixed shall be deemed to be the ordinary rates of wages of the workers.

For the purpose of this section, "ordinary rates of wages" means the basic wages plus such allowances, including the cash equivalent of the advantages given to the worker in the form of concessional sales of foodgrains etc., if any, but does not include a bonus.

The cash equivalent of the advantages referred to above shall be computed as often as prescribed on the basis of the maximum quantity of foodgrains etc., admissible to a "standard family". The term "standard family" means a family consisting of the worker, his or her spouse and two children below the age of 14, requiring in all three adult consumption units. "Adult consumption unit" means the consumption unit of a male above the age of 14. The consumption unit of a female above 14 and that of a child below 14 shall be calculated at the rates of 0.8 and 0.6 respectively of one adult consumption unit. The State Government may make rules regarding the calculation of cash equivalents and the registers to be kept. Sec. 59.

Double Employment : No adult worker shall be required or allowed to work in any factory on any day on which he has already been working in any other factory, save in such circumstances as may be prescribed. Sec. 60.

Notice of Periods of Work : There must be displayed in every

factory, a notice showing, periods of work of adults, classification of workers in groups according to nature of their work, shifts and relays etc. Changes made in the system of work must be notified to the Inspector before change. The manager of every factory must maintain a Register of Adult Workers showing the name of each worker, the nature of his work, the group in which he is included, the relay in which he is allotted etc. The hours of work of an adult worker must correspond with the notice referred to above and the Register. Sections 61, 62, 63.

Exemptions: By sections 64 and 65, the State Government has been given power to exempt for limited periods certain factories from compliance with some of the provisions relating to hours of work and employment. Such exemption are necessary in special cases, for example in the case of workers engaged in urgent repairs or in preparatory and complementary work. In some industries work is of an intermittent character and the enforcement of all the rules stated above will create hardship. The nature of the work in certain industries requires exceptional treatment *e.g.* workers engaged in engine rooms and boilers or in the printing of newspapers. The State Government may exempt persons holding positions of supervision and management or in confidential positions in a factory from the operation of the rules regarding working hours (except the rule against the employment of women at night).

Restrictions on the employment of women. By section 66 the following additional restrictions have been imposed as regards women workers :

(a) No exemption from the provisions of Section 54 (which lays down that the maximum daily hours of work shall be nine hours) can be granted in respect of any woman.

(b) No woman shall be employed in any factory except between the hours of 6 a.m. and 7 p.m. The State Government may by notification in the official Gazette vary the limits for particular factories or classes of factories. But such variation must not authorise the employment of women between the hours 10 p.m. and 5 a.m.

(c) There shall be no change of shifts for women except after a weekly holiday or any other holiday.

There is one exceptional case. The State Government may make rules providing for the exemption from the aforesaid restrictions (wholly or partially or conditionally) of women working in fish-curing or fish-canning factories, where the employment of women beyond the hours specified is necessary to prevent damage to or

deterioration in any raw material. But such rules shall remain in force for not more than three years at a time.

RULES REGARDING THE EMPLOYMENT OF NON-ADULT WORKERS

Employment of children: No child who has not completed his fourteenth year shall be required or allowed to work in any factory. Sec. 67.

Certificate of fitness and Token: A child who has completed his fourteenth year or an adolescent shall not be required or allowed to work in any factory unless (a) he has been granted a certificate of fitness, which is in the custody of the manager, and (b) such child or adolescent carries a token giving a reference to such certificate. Sec. 68.

The Certificate of Fitness is a certificate granted to a child or adolescent by a Certifying Surgeon after examination. The certificate is given to a child if the surgeon is satisfied that he has completed his fourteenth year and has attained the prescribed physical standards. The certificate is granted to an adolescent if the surgeon is satisfied that he has completed his fifteenth year and is fit for a full day's work in a factory. The certifying surgeon must have personal knowledge of the intended place of work and of the manufacturing process involved. The certificate is valid only for a period of 12 months. It may be granted subject to conditions (e.g. that of periodical re-examination). The certificate may be renewed and, if necessary, revoked. Any fee payable for the certificate must be paid by the occupier of the factory and must not be recovered from the young person or his parents or guardian. Sec. 69.

An adolescent who has been granted a certificate of fitness and who carries a token is deemed to be an adult for the purposes of Chs. VI and VIII of the Act. (Ch. VI deals with the hours of work of an adult and Ch. VIII deals with annual leave). But no adolescent who has not attained the age of seventeen years shall be employed or permitted to work in any factory during night. "Night" means a period of at least 12 consecutive hours which shall include an interval of at least seven consecutive hours falling between 10 p.m. and 7 a.m. An adolescent who has not been granted a certificate of fitness, shall be deemed to be a child for the purposes of the Act. Sec. 70.

Working hours for children. (Sec. 71): (1) No child shall be employed or permitted to work in any factory—

(a) for more than four and a half hours in any day ;

(b) during the night.

Explanation : For the purpose of this sub-section "night" shall mean a period of at least twelve consecutive hours which shall include the interval between 10 p.m. and 6 a.m.

(2) The period of work of all children employed in a factory shall be limited to two shifts which shall not overlap or spread-over more than five hours each, and each child shall be employed in only one of the relays which shall not, except with the previous permission in writing of the Chief Inspector, be changed more frequently than once in a period of thirty days.

(3) The provisions of section 52 shall apply also to child workers, and no exemption from the provisions of that section may be granted in respect of any child.

(4) No child shall be required or allowed to work in any factory on any day on which he has already been working in another factory.

Notice and Register : A notice must be displayed showing clearly the periods of work of children. Sec. 72.

The manager of every factory must maintain a Register of child workers showing the name of each child worker, the nature of his work, the group (if any) in which he is included, the relay to which he is allotted and the number of his certificate of fitness. Sec. 73.

The hours of work of a child must correspond with the Notice and the Register. Sec. 74.

Medical Examination : Where an Inspector is of opinion that a person working as an adult is a young person, or that a young person is not fit to work, he may direct the manager of the factory to have the person medically examined by a certifying surgeon. Sec. 75.

Miscellaneous : The State Government may make rules regarding the forms of the Certificate of Fitness, the procedure relating to their issue, and the physical standards to be attained by children and adolescents. Sec. 76.

The provisions relating to the employment of young persons shall be in addition to, and not in derogation of, the provisions of the Employment of Children Act of 1938. Sec. 77. (See Ch. 7).

HOLIDAYS AND LEAVE

The Factories Act provides for two types of holidays, viz.,

Weekly holidays and Compensatory holidays. It also provides for the grant of Annual leave with wages according to certain rules. The provisions are explained below.

Weekly Holidays. Section 52 provides that an adult worker shall have a holiday on the first day of the week. But the manager of the factory may fix the holiday on any other day, which is within three days before or after the first day of the week. In case of such substitution, notice must be given to the Inspector of Factories and displayed in the factory. No substitution can be made which will result in any worker working for more than ten days consecutively without a holiday for a whole day. The State Government may make rules providing for exemption from the above section in certain cases, *e.g.*, for urgent repairs.

Compensatory Holidays. Where the State Government has exempted a factory from the operation of the rule regarding weekly holidays, a worker who has been deprived from any weekly holiday shall be allowed within the month in which the holidays were due, or within two months immediately following that month, compensatory holidays of equal number to the holidays lost. Sec. 53.

Annual Leave with Wages. Sections 78 to 84 provide for the grant of a certain period of leave with wages to workmen. Where by virtue of any award, agreement or contract of service the worker is entitled to a longer period of leave than that provided by the aforesaid rules, he will be entitled to such longer leave. The rules contained in these sections do not apply to railway workshops administered by the Government which are governed by leave rules approved by the Central Government.

Every worker who has worked for a period of 240 days or more in a factory during a calendar year shall be allowed during the subsequent calendar year, leave with wages for a number of days calculated at the rate of

- (i) if an adult, one day for every twenty days of work performed by him during the previous calendar year ;
- (ii) if a child, one day for every fifteen days of work performed by him during the previous calendar year.

Other rules regarding the Annual Leave are summarised below.

(1) When counting the number of days of work performed by a worker, the following are to be included: (a) days of lay-off, (b) maternity leave to a female worker, not exceeding twelve weeks, and (c) the leave earned in the previous year. But the worker shall not earn leave for these days.

(2) The leave admissible under the aforesaid rule shall be exclusive of all holidays whether occurring during or at either end of the period of leave.

(3) A worker whose service commences otherwise than on the first day of January shall be entitled to leave with wages at the rate laid down above if he has worked for two-thirds of the total number of days in the remainder of the calendar year.

(4) If a worker is discharged or dismissed during the course of the year, he will be entitled to leave even though he has not worked for the minimum necessary period.

(5) In calculating the leave period, fraction of leave for half a day or more shall be treated as one day and fractions of less amount shall be omitted.

(6) Leave earned, but not taken, can be carried forward to a succeeding year subject to a limit of thirty days in the case of an adult and forty days in the case of a child. But earned leave not allowed because of any scheme for leave in operation, can be carried forward without limit.

(7) Application for leave must be submitted to the manager not less than 15 days before the date of commencement of leave. In the case of public utility services it must be made not less than 30 days before such date. If a worker becomes ill and wants to avail himself of the annual leave during the period of illness, he shall be granted leave even though the application is not made before the period specified above.

(8) The application for leave may be for the whole of the leave due or part of it. But earned leave cannot be taken more than three times during the same year.

(9) For the purpose of ensuring the continuity of work, the occupier or manager of the factory may draw up a Scheme for regulating the grant of leave. The Scheme must be agreed to by the Works Committee, if any, or the representatives of workers. It must be lodged with the Chief Inspector and displayed in the factory.

(10) An application for leave submitted in proper time shall not be refused, unless the refusal is in accordance with any leave scheme in operation.

(11) The unavailed leave of a worker shall not be taken into consideration in computing the period of any notice required to be given before discharge or dismissal.

(12) The State Government may exempt a factory from the operation of the above rules if it is satisfied that its own leave rules

provide benefits which are not less favourable to the workers than the statutory leave rules.

Wages during Leave Period. For the period of leave allowed to a worker according to rules, he shall be paid at a rate equal to the daily average of his total full-time earnings for the days on which he worked during the month immediately preceding his leave. The average rate is to be calculated, exclusive of any overtime and bonus, but inclusive of dearness allowance and the cash equivalent of the advantage accruing through the concessional sale to the worker of foodgrains and other articles. The cash equivalent, referred to above, is to be computed according to the method used when calculating the extra wages payable for overtime work. (See *ante*). Sec. 80.

If the employment of a worker who is entitled to leave is terminated by the occupier of the factory before he has taken the entire leave to which he is entitled, he must be paid wages for the leave period not taken and such wages must be paid before the expiry of the second working day after such termination. Similarly, if the worker quits his service after having applied for and obtained leave, he must be paid wages for the leave period and such wages must be paid on or before the next pay day. The amount of wages payable is to be calculated according to the provisions of Section 80. Sec. 79 (11).

A worker who has been allowed leave for not less than four days in the case of an adult and five days in the case of a child, shall, before his leave begins, be paid the wages due for the period of leave allowed. Sec. 81.

Wages for the leave period, if not paid by an employer, shall be recoverable as delayed wages under the provisions of the Payment of Wages Act, 1936. (See *post*). Sec. 82.

OTHER PROVISIONS OF THE FACTORIES ACT

A brief summary is given below of the other provisions of the Factories Act.

Departments as Factories. The State Government may, upon application, declare that for the purposes of the Act, different departments or branches of a factory shall be treated as separate factories or that two or more factories of the occupier shall be treated as the same factory. Sec. 4.

Exemption during Public Emergency. Factories or any class of factories may be exempted from the operation of any of the provisions of the Act during a public emergency (except that of Sec. 67, employ-

ment of children) for such periods and subject to such conditions as the Government may think fit. The exemption is to be made by notification in the official Gazette for a period not exceeding three months at a time. Sec. 5.

Exemption of Public Institutions. The State Government may exempt, subject to such conditions as it may consider necessary, any workshop or workplace where a manufacturing process is carried on and which is attached to a public institution maintained for the purposes of education, training or reformation from all or any of the provisions of the Act. But no exemption is to be granted from the provisions relating to hours of work and holidays unless there is a scheme relating to such matters containing rules not less favourable to the workers than the provisions of the Act. Sec. 86.

Dangerous Operations. The State Government is empowered to make special rules for the purpose of controlling and regulating factories which carry on operations which expose workers to a serious risk of bodily injury, poisoning or disease. Sec. 87. Rules have been made providing for medical examination, protection of workers restricting and controlling the use of particular materials and processes etc.

Notifiable Accidents. The manager of a factory must send a notice to the authorities whenever an accident occurs which causes death or which causes bodily injury preventing the worker from working for a period of 48 or more hours or other types of injury which may be specified by rules. Sec. 88.

Notifiable Diseases. The manager of a factory must send notice to the authorities whenever a worker contracts any of the diseases mentioned in the Schedule to the Act. (These are known as Occupational Diseases. *Examples* : poisoning by lead, mercury, phosphorus etc.; anthrax; silicosis; cancer of the skin; toxic anæmia or jaundice; etc.). The medical practitioner attending the person, if any, shall without delay send a report to the Chief Inspector in writing, stating the name of the person affected and other particulars. Sec. 89.

Enquiry into Accidents and Diseases. The State Government may appoint a competent person to enquire into the causes of any accident occurring in a factory or of a notifiable disease, and may also appoint one or more persons possessing legal or special knowledge to act as assessors in such enquiry. The person appointed to enquire can call witnesses like a Civil Court and exercise any of the powers of an Inspector. He must submit a report to the State Government, together with his observations. The report or extracts therefrom may be published. Sec. 90.

✓ **Penalties and Procedure.** Sections 92 to 106 lay down the rules regarding penalties for offences against the Act. The owner of any premises, let out for use as different factories, is responsible for the provision and maintenance of common facilities and services, *e.g.*, approach roads, drainage, water supply, latrines etc. In most cases the occupier of the factory is responsible for offences committed against the Act. But the occupier is exempted from liability if he can show that he has used due diligence to enforce the execution of the Act and that some other person committed the offence without his knowledge, consent or connivance. The penalties for some of the offences are mentioned below.

Offence		Imprisonment		Fine
Obstructing Inspector	..	Up to 3 months and/or		up to Rs. 500.
Wrongfully disclosing results of analysis of sample	..	" " " "		"
Contravention of any duty or liability by a worker	..	nil		Rs. 20
Using false certificate of fitness	..	1 month	"	Rs. 50
Permitting double employment of child	..	nil		Rs. 50
Cases not otherwise provided for	..	3 months	"	Rs. 500
Second offence for above	..	6 months	"	Rs. 1000

No court can take cognizance of an offence under the Act except on a complaint by or with the previous sanction of an Inspector in writing. Only a Presidency Magistrate or a Magistrate of the first class can try offences under the Act. The complaint must be filed within 3 months of the date when the commission of the offence came to the knowledge of an Inspector. For disobeying a written order of an Inspector, complaint may be filed within 6 months of the date when the offence was committed.

A person found in the factory when the factory is going on or the machinery is in motion, except during the time of meal or rest, is presumed to be employed in the factory until the contrary is proved.

When in the opinion of the Court a person is *prima facie* under-age, the burden shall be on the accused to show that such person is not under-age.

✓ **Appeals.** The manager or the occupier of a factory on whom an order in writing has been served by an Inspector can appeal against it to the prescribed authority within thirty days. Sec. 107.

Notices. In certain cases (prescribed by the rules) abstracts of the Act and the rules are required to be displayed in the factory. All notices under the Act must be displayed in English and in a language understood by the majority of the workers employed therein. They must be displayed in a conspicuous and convenient place at or near the main entrance of the factory and must be maintained in a clean and legible condition. The Chief Inspector may require the display of posters relating to the health, safety and welfare of workers. Sec. 108.

Returns. The owners, managers and occupiers of factories are required by rules to submit various returns and reports. Sec. 110.

Power of the Central Government. The Central Government may give directions to a State Government as to the carrying into execution of the provisions of the Act. Sec. 113.

Obligations of Workers. Section 111 lays down that no worker in a factory—

- (a) shall wilfully interfere with or misuse any appliance, convenience or other thing provided in a factory for the purpose of securing the health, safety or welfare of the workers therein ;
- (b) shall wilfully and without reasonable cause do anything likely to endanger himself or others ; and
- (c) shall wilfully neglect to make use of any appliance or other thing provided in the factory for the purposes of securing the health or safety of the workers therein.

If any worker contravenes any of the provisions of this section or of any rule or order made thereunder he shall be punishable with imprisonment which may extend to 3 months or with fine which may extend to Rs. 100 or with both.

CHAPTER 3

INDUSTRIAL RELATIONS

The law relating to industrial relations in India is contained in the Industrial Disputes Act of 1947 and several local Acts passed in States (*e.g.* in Bombay). The Industrial Disputes Act is a Central Act which came into operation on 1st April, 1947. It applies to the whole of India, subject to the proviso that in the State of Jammu and Kashmir it applies only to workmen employed under the Government of India.

The object of the Act is, "to make provision for the investigation and settlement of industrial disputes, and for certain other purposes." The aim of the Act is to secure industrial peace through voluntary negotiation and compulsory adjudication. It lays down the procedure according to which disputes between employers and workmen can be settled.

INDUSTRY

The term "industry" is ordinarily used to mean an establishment where goods are manufactured. The Industrial Disputes Act, however, uses the term in a wide sense.

Section 2 (j) defines an "industry" as "any business, trade, undertaking, manufacture or calling of employers and includes any calling, service, employment, handicraft, or industrial occupation or avocation of workmen."

From this definition it follows that according to the Industrial Disputes Act, "industry" includes (i) manufacturing establishments, (ii) agricultural farms, (iii) commercial houses, and (iv) non-profit organisations like hospitals, schools and colleges. All these establishments come within the scope of the Act.

Example : The Western India Automobile Association which renders service to its members on a non-profit basis has been held to be an "industry" within the meaning of the Act.

INDUSTRIAL DISPUTES

According to Section 2 (k) of the Act, "industrial dispute" means any dispute or difference between employers and employees, or between employers and workmen, or between workmen and work-

men, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour of any person."

A dispute or difference between (a) employers and employers (b) employers and workmen and (c) workmen and workmen, is an industrial dispute according to the Act provided the dispute or difference relates to (i) employment or non-employment (ii) terms of employment, or (iii) the conditions of employment.

Dispute or difference arises when a demand is made by one party and is refused by the other party. The demand may be oral or in writing. A request contained in a letter from workmen may amount to a demand. If the request is not complied with a dispute arises. A demand may be made by a group of workmen or by a Union on their behalf. Dispute with an individual workman may become an industrial dispute if the workman is supported by other workmen or the Union.

Examples :

- (i) Two employees of a municipality were dismissed on certain charges and a dispute arose between the municipality and the workers employed by it. It was held that the dispute was an industrial dispute because in the definition of the term "industrial dispute" the word "undertaking" is used and a municipality is an undertaking which supplies light or water for payment. *D. N. Banerjee v. P. R. Mukherjee*.¹
- (ii) The term 'industry' does not include the case of an individual who carries on a profession dependent on his own intellectual skill. The calling of a solicitor is not an industry, so long as he carries on the normal avocations of a solicitor. Therefore, a dispute between a firm of solicitor and its employees is not an industrial dispute. (The calling of a solicitor may become an industry under certain circumstances, e.g. when he carries on an investment business.) *Brijmohan Bagaria v. N. C. Chatterjee*.²
- (iii) A Union of workmen wrote a letter to the employers, in very courteous and polite language requesting additional bonus. The request was refused. Held that an industrial dispute arose from the refusal. *Sree Minakshi Mills v. State of Madras*.³
- (iv) An industrial dispute can be raised over events which took place before the passing of the Industrial Disputes Act. Also, there can be an industrial dispute between the employer and his discharged workmen. *Birla Brothers Ltd, v Modak*.⁴

¹ (1953) S.C.A. 303

² C.W.N. 473

³ A.I.R. (1951) Mad. 974

⁴ I.L.R. 1948 (2) Cal. 209

WORKMAN

The definition of the term 'workman' as given in Section 2 (s) of the Act can be summarised as follows : Workman means any person (including an apprentice) employed in an industry to do any skilled or unskilled manual, supervisory, technical or clerical work for hire or reward. The terms of employment may be either express or implied. A workman who has been dismissed, discharged or retrenched, comes within the definition of the term 'workman' if there is any dispute relating to such dismissal, discharge or retrenchment. The Act *excludes* the following types of workers from the definition of 'workman'—

- (i) Persons subject to the Army Act, 1950, or the Air Force Act, 1950 or the Navy (Discipline) Act, 1934.
- (ii) Persons employed in the police service or a prison.
- (iii) Persons employed mainly in a managerial or administrative capacity.
- (iv) Persons employed in a supervisory capacity drawing wages exceeding Rs. 500 per month or exercising functions mainly of a managerial nature.

With the exception of the four excluded categories stated above, every person working in industry, for hire or reward, is a workman.

Examples of workmen :

A gardener working at an officer's quarters but whose name is on the company's pay-roll ; a salesman who draws wages and not commission ; an auditor employed in the concern and doing mainly clerical work ; workers engaged by a contractor if the contractor is an employee of the principal concern and not an independent contractor. Casual and temporary workers are not workmen after the job for which they are engaged is finished. The non-permanent staff of seasonal factories are not workmen during the off-season when work is not being carried on.

AUTHORITIES UNDER THE ACT

The Act sets up certain authorities for the investigation and settlement of industrial disputes. They are (i) Works Committees (ii) Conciliation Officers (iii) Boards of Conciliation (iv) Courts of Enquiry (v) Labour Courts (vi) Tribunals and (vii) National Tribunals. The powers and duties of these authorities are explained below.

The National Tribunals are constituted by the Central Government. The other authorities, (Conciliation Officers etc.) are appointed

by the Appropriate Government—an expression which is defined in Section 2 (a) of the Act.

Appropriate Government. The Central Government is the Appropriate Government in relation to an industrial dispute concerning (i) any industry carried on by or under the authority of the Central Government (ii) a railway (iii) any controlled industry, and (iv) a banking or an insurance company, a mine, an oil field or a major port. In relation to all other industrial disputes, the State Government is the Appropriate Government.

WORKS COMMITTEE

The Works Committee is a committee consisting of representatives of employers and workmen engaged in an industry. Sec. 3. In the case of any industrial establishment in which 100 or more workmen are engaged, the Appropriate Government may direct the employer to constitute a Works Committee in the manner prescribed by the rules framed under the act. The number of representatives of workmen must not be less than the number of representatives of the employer. The representatives of workmen are to be selected from the men engaged in the establishment in consultation with their Trade Union, if there is any registered Union.

Duties : It shall be the duty of the Works Committee to promote measures for securing and preserving amity and good relations between the employer and workmen. With this end in view, the Committee is to comment upon matters of their common interest or concern and endeavour to compose any material difference of opinion in respect of such matters.

CONCILIATION OFFICERS

Section 4 of the Act provides for the appointment of Conciliation Officers by the Appropriate Government. A conciliation officer may be appointed for a specified area or for a specified industry or industries in an area.

Duties : Conciliation Officers are charged with the duty of mediating in and promoting the settlement of industrial disputes. Section 12 provides as follows :

(1) Where an industrial dispute exists or is apprehended, the conciliation officer may hold conciliation proceedings in the prescribed manner. Where the dispute relates to a public utility service and the necessary notice (under Sec. 22) has been given, he *shall* hold such proceedings (See *post*).

water or air ; banking ; cement, coal, cotton textiles, foodstuffs, iron and steel, defence establishments ; service in hospitals and dispensaries ; fire brigade service.

There is a general prohibition of strikes and lock-outs in certain cases. Section 23 provides that no workman who is employed in any industrial establishment shall go on strike in breach of contract and no employer of any such workman shall declare a lock-out—

- (a) during the pendency of conciliation proceedings before a Board and seven days after the conclusion of such proceedings ;
- (b) during the pendency of proceedings before a Labour Court, Tribunal or National Tribunal and two months after the conclusion of such proceedings ; or
- (c) during any period in which a settlement or award is in operation, in respect of any of the matters covered by the settlement or award.

Section 24 provides that a strike or lock-out is illegal if (i) it is commenced or declared in contravention of section 22 and 23 or (ii) it is continued in contravention of an order made under sub-section (3) of Section 10. Section 10 (3) provides that where an industrial dispute has been referred to a Board, Labour Court, Tribunal or National Tribunal, the appropriate Government may by order prohibit the continuance of a strike or lock-out in connection with such dispute which may be in existence on the date of the reference.

Where a strike or lock-out is already in existence at the date of the reference to a Board, Labour Court, Tribunal or National Tribunal, the continuance of such strike or lock-out is not illegal provided that such strike or lock-out was not illegal at its commencement. Sec. 24 (2).

A lock-out declared in consequence of an illegal strike or a strike declared in consequence of an illegal lock-out shall not be deemed illegal. Sec. 24 (3).

No person shall knowingly expend or apply any money in direct furtherance or support of any illegal strike or lock-out. Sec. 25.

Penalties : The penalties provided for violation of the rules regarding strikes and lock-outs are as follows :

Any workman who commences, continues or acts in furtherance of an illegal strike—imprisonment up to one month or fine up to Rs. 50 or both.

Any employer who commences, continues or acts in furtherance

of an illegal lock-out—imprisonment up to one month or fine up to Rs. 1,000 or both.

Instigating or inciting an illegal strike or lock-out—imprisonment up to six months or fine up to Rs. 1,000 or both.

Financial aid to illegal strikes and lock-outs—imprisonment up to six months or fine up to Rs. 1,000 or both.

LAY OFF AND RETRENCHMENT

Rules regarding lay off and retrenchment are laid down in sections 25A to 25E of the Act. These rules do not apply to—

- (a) an industrial establishment in which less than 50 workmen on an average were employed per working day in the preceding calendar month, or
- (b) an industrial establishment which is of a seasonal character or where work is carried on intermittently.

An “industrial establishment” for the purposes of these sections means (i) a factory as defined in Section 2 (m) of the Factories Act, 1948, or (ii) a mine as defined in Section 2 (j) of the Mines Act, 1952, or (iii) a plantation as defined in Section 2 (f) of the Plantation Labour Act, 1951.

Lay Off. “Lay Off” means the failure, refusal or inability of an employer to give employment to a workman whose name is borne on the muster rolls of his industrial establishment and who has not been retrenched. Lay Off may be due to shortage of coal, power or raw materials or the accumulation of stocks or the breakdown of machinery or for any other reason.

The Act provides that if a workman presents himself at the normal time and is not given employment within two hours, he is deemed to have been laid off for the day. If the workman, instead of being given employment at the commencement of any shift for any day, is asked to present himself during the second half of the shift for the day and is given employment then, he is deemed to have been laid off for one-half of the day. If the workman is not given any employment when he presents himself during the second half of the shift as asked, he becomes entitled to full basic wages and dearness allowance for that part of the day.

Lay Off is to be distinguished from Retrenchment. Lay Off is a temporary inability or refusal to give employment. Retrenchment is termination of the services of a workman.

Since employment is for wages, if a workman is paid for the day but given no work, it is not a case of lay off.

Compensation to workmen laid off : Section 25C provides for the payment of compensation to a workman who is laid off. The rules regarding compensation can be summarised as follows :—

1. To be entitled to compensation, the workman must not be a *badli* workman or a casual workman. His name must be on the muster rolls of the establishment. Also, he must have completed not less than one year of continuous service.

[*Badli* workman means a workman who is employed in an industrial establishment in place of another workman whose name is borne on the muster rolls of the establishment. A *badli* workman ceases to be regarded as such if he has completed one year of continuous service in the establishment.]

[“*One year of continuous service*” : A workman who, during a period of 12 calendar months, has actually worked in an industry for not less than 240 days shall be deemed to have completed one year of continuous service. In computing the period of service the following are to be *included*—(a) days during which the workman was laid off under an agreement or the standing orders or under the Act ; (b) days during which he was on leave with full pay, earned in the previous year ; and (c) in the case of a female, the days during which she was on maternity leave (subject to a maximum of 12 weeks).]

2. The rate of compensation is 50% of the total of the basic wages and dearness allowance that would have been payable to him had he not been laid off.

3. The workman is entitled to compensation for all days during which he is laid off (except for such weekly holidays as may intervene). But the compensation payable during any period of twelve months shall not be for more than 45 days, unless the case comes under the next following rule.

4. If during any period of 12 months, a workman is laid off for more than 45 days, whether continuously or intermittently and the lay off after the expiry of the first 45 days comprises continuous periods of one week or more, the workman shall, unless there is any agreement to the contrary between him and the employer, be paid compensation at the above-mentioned rates for all the days comprised in every such subsequent period of lay off for one week or more. [The workman may be retrenched after the expiry of the first 45 days of lay off.]

When no compensation is payable : Section 25E provides that no compensation is payable in the following cases :—

(i) If the workman refuses to accept any alternative employ-

ment in the same establishment or in any other establishment belonging to the same employer situated in the same town or village or situated within a radius of five miles from the establishment to which he belongs, if, in the opinion of the employer, such alternative employment does not call for any special skill or previous experience and can be done by the workman. [The same wages must be offered for the alternative employment.]

(ii) If the workman does not present himself for work at the establishment at the appointed time during normal working hours at least once a day.

(iii) If such laying off is due to a strike or slowing down of production on the part of workmen in another part of the establishment.

Retrenchment. The Act defines retrenchment as, "the termination by the employer of the services of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, but does not include—

- (a) voluntary retirement of the workman ; or
- (b) retirement of the workman on reaching the age of superannuation if the contract of employment between the employer and the workman concerned contains a stipulation in that behalf ; or
- (c) termination of the service of a workman on the ground of continued ill-health."

Section 25F provides that a workman who has been in continuous service for not less than one year under an employer shall not be retrenched by that employer unless all the following conditions are fulfilled :

(a) The workman is given one month's notice in writing indicating the reasons for retrenchment and the period of notice has expired or the workman has been paid in lieu of notice, wages for the period of notice. But no notice is necessary if the retrenchment is under an agreement which specifies a date for the termination of service.

(b) The workman has been paid, at the time of retrenchment, compensation equivalent to 15 days average pay for every completed year of service or any part thereof in excess of 6 months.

(c) Notice in the prescribed manner is served on the appropriate Government.

Section 25G provides that when any workman of a particular

category has to be retrenched, the employer shall select for retrenchment the person who was last to be employed in that category. This rule applies only if the workman is a citizen of India. The employer may deviate from this rule of "last in, first out" for reasons to be recorded in writing.

Section 25H provides that when the employer appoints new personnel, retrenched workmen, if any, who offer themselves for re-employment shall have preference over other persons.

Transfer of undertakings: Section 25FF provides that where the ownership or management of an undertaking is transferred, whether by agreement or by operation of law to a new employer, every workman who has been in continuous service for not less than one year in that undertaking immediately before such transfer shall be entitled to notice and compensation (as if he had been retrenched) unless the following conditions are satisfied:—

- (a) the service of the workman has not been interrupted by such transfer;
- (b) the terms and conditions of service applicable to the workman after such transfer are not in any way less favourable to the workman than those applicable to him immediately before the transfer; and
- (c) the new employer is, under the terms of such transfer or otherwise, legally liable to pay to the workman, in the event of his retrenchment, compensation on the basis that his service has been continuous and has not been interrupted by the transfer.

Closing down of undertakings: Section 25FFF provides that where an undertaking is closed down for any reason whatsoever, every workman who has been in continuous service for not less than one year in that undertaking immediately before that closure shall (subject to the qualifications mentioned below) be entitled to notice and compensation, as if the workman had been retrenched.

Where the undertaking is closed down on account of unavoidable circumstances beyond the control of the employer, the compensation to be paid shall not exceed the average pay of the workman for three months. Financial difficulties (including financial losses) or accumulation of undisposed stocks shall not be deemed "unavoidable circumstances" within the meaning of this rule.

Where any undertaking set up for the construction of buildings, bridges, roads, canals or other construction work is closed down on account of the completion of the work within two years from the date

on which the undertaking had been set up, no workman shall be entitled to any compensation. If the construction work is not completed within two years, he shall be entitled to notice and compensation for every completed year of service or any part thereof in excess of six months.

CHANGE IN THE CONDITIONS OF SERVICE

Section 9A provides that the conditions of service (applicable to any workman in respect of any matter specified in the 4th schedule to the Act) cannot be changed without giving notice to the persons affected and within 21 days of giving such notice.

But no notice is required (a) where the change is effected in pursuance of any settlement, award or decision of the Labour Appellate Tribunal formerly in existence, and (b) where the workman is subject to the rules applicable to Government servants and railway establishments.

The 4th schedule to the Act contains a list of the conditions of service which cannot be changed except in the manner laid down in Section 9A. The important items are wages allowances, hours of work etc.

The appropriate Government can exempt any class of industrial establishment or any class of workmen from the operation of Section 9A if it is of opinion that the application of the provisions of that section will affect employers so prejudicially that there will arise serious repercussion on the industry concerned. Sec. 9B.

When proceedings relating to an industrial dispute are pending before an Authority, the conditions of service of the workmen relating to any matter connected with the dispute cannot be changed to the prejudice of the workman without the written permission of the Authority. Such workmen cannot be punished or discharged for any misconduct connected with the dispute without the permission of the authority. Sec. 33 (1).

Regarding matters not connected with the dispute, the conditions of service may be changed and the workman may be punished in accordance with the standing orders of the establishment. But no workman can be discharged unless he is paid one month's wages and the discharge is approved by the Authority. Sec. 33 (2).

But a "protected workman" cannot be punished or discharged, nor can his terms of service be altered without the express permission of the Authority. A "protected workman" is one who is an officer of a registered trade union connected with the establishment and is

recognised as such in accordance with the rules. In every establishment the number of workmen to be recognised as protected shall be one per cent of the total number of workmen, subject to a minimum of five and a maximum of one hundred. Sec. 33 (3) & (4).

When an employer contravenes any of the aforesaid provisions during the pendency of proceedings before a Labour Court, Tribunal or National Tribunal, any employee aggrieved can make a complaint in writing to the authority before which proceedings are pending and such authority shall adjudicate upon the complaint as if it were a dispute referred to or pending before it. Sec. 33A.

Penalty—An employer who contravenes the provisions of Section 33 can be punished with imprisonment up to six months or fine up to Rs. 1,000 or both. Sec. 31 (1).

OFFENCES AND PENALTIES

Whoever contravenes any of the provisions of the Act or any rule made thereunder shall, if no other penalty is elsewhere provided by or under this Act, be punishable with fine which may extend to Rs. 100. Sec. 31 (2).

Where a person committing an offence under this Act is a company or an association, every director, manager, secretary, agent or other officer or person concerned with the management thereof shall, unless he proves that the offence was committed without his knowledge or consent, be deemed to be guilty of such offence. Sec. 32.

No court shall take cognizance of any offence punishable under this Act, same on complaint made by or under the authority of the appropriate Government. Sec. 34(1).

No court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence punishable under this Act. Sec. 34(2).

RECOVERY OF MONEY FROM EMPLOYER

A workman entitled to receive money from an employer may apply to the Government to use the special procedure available for the realisation of arrears of land revenue and known as the Certificate procedure. The workman may also use any other method of recovery if he wishes. Any benefit which can be computed in terms of cash can be similarly recovered. The Labour Court may appoint a Commissioner to compute the cash value of any benefit. Sec. 33C.

PROTECTION OF PERSONS

A member of a trade union or of a society cannot be expelled or in any other way punished by the union or society for refusing to take part in an illegal strike or lock-out. If any person is expelled on such grounds, the Civil Court may, order the restoration of his membership or alternatively direct that he be paid out of the funds of the union or society such sum by way of compensation as the court thinks just. Sec. 35.

REPRESENTATION OF PARTIES

A workman who is a party to a dispute shall be entitled to be represented in any proceeding under the Act by (a) an officer of the trade union of which he is a member, or (b) an officer of the federation of unions with which his trade union is affiliated, or (c) where the worker is not a member of any union, by an officer of any trade union connected with or by any workman employed in, the industry in which the workman is employed. The representative must be authorised in the prescribed manner. Sec. 36 (1).

An employer who is a party to a dispute is entitled to be represented by (a) any officer of the federation of associations with which the association referred to above is affiliated, or (c) where he is not a member of any association of employers, by an officer of any association of employers, connected with or by any other employer engaged in the same industry. The representative must be authorised in the prescribed manner. Sec. 36 (2).

No party to a dispute shall be entitled to be represented by a legal practitioner in any conciliation proceedings under this Act or in any proceedings before a Court. Sec. 36 (3).

In any proceedings before a Labour Court, Tribunal or National Tribunal, a party may be represented by a legal practitioner with the consent of the other parties and with the leave of the Labour Court, Tribunal or National Tribunal as the case may be. Sec. 36 (4).

The director of a company can represent the company even if he be a lawyer. *Hall & Anderson Ltd. v. S. K. Neogy*.³

CHAPTER 4

EMPLOYEES' STATE INSURANCE

INTRODUCTION

Persons who earn income from work (for example, industrial and agricultural labourers) find themselves in great difficulty when their earning power is affected by sickness, accident, maternity, old age or unemployment. It is not possible for workmen individually to make an adequate provision against these risks because their incomes are too low. Workmen find it almost impossible to save and cannot afford to insure themselves against any risk. Hence they suffer from economic insecurity. The system of social insurance has been developed to eliminate the economic insecurity of working classes.

Social insurance can be described as a system under which specified groups of people are compulsorily insured against certain specified risks like sickness, accident or maternity. Whenever any of these contingencies occur, the insured person is paid certain benefits (by cash or otherwise) out of a fund created by contributions from the insured person, his employer, and the State. The coverage *i.e.* the persons insured and the contingencies insured against, the rates of contribution and the methods of administering the system, differ from country to country.

Great Britain has a comprehensive system of social insurance. It covers practically all citizens not belonging to the richer classes and provides against all the usual risks to which poor people are exposed. The present British system is governed by the National Insurance Act of 1946 and certain other statutes. The Government administers the system and bears the major part of the cost. In U.S.A. social insurance schemes are generally administered by non-government agencies *e.g.* a joint committee of the representatives of the employer and the trade union concerned. Social insurance schemes exist in other countries also, *e.g.* West Germany.

As a method of eliminating economic insecurity, social insurance has been found to be highly successful in all countries where it has been tried. With a view to adopting the system in India, the Employees' State Insurance Act of 1948 was passed.

The object of the Employees' State Insurance Act, 1948, is to introduce social insurance in India by gradual stages. The Act creates a statutory corporation, called the Employees' State Insurance Corporation which is in charge of the scheme of insurance. It lays down the constitution and functions of the Corporation and the administrative machinery associated with it. It also states the rules regarding the contributions to be paid by employers and employees and the benefits to be given to the latter.

The Employees' State Insurance Act extends to the whole of India except the State of Jammu and Kashmir. The insurance scheme contained in the Act has, up till date, been applied to a few selected industries in certain selected localities. The Act provides that it will come into force on such date or dates as the Central Government may decide and that different dates may be appointed for different provisions of the Act and for different States or for different parts thereof. The reason for this piecemeal application is that in a large and diversified country like India it takes time to build up the necessary administrative organisation. The area of operation of the Act will be extended as the organisation is further developed.

WHO ARE INSURABLE WORKMEN?

Section 1 (4) of the Act states that the Act shall apply in the first instance to all factories (including government factories) except seasonal factories.

The term Factory is defined in Section 2(12) as follows: "Factory means any premises including the precincts thereof whereon twenty or more persons are or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power or is ordinarily so carried on but does not include a mine subject to the operation of the Mines Act, 1923 or a railway running shed."

✓ "A seasonal factory means a factory which is exclusively engaged in one or more of the following processes, namely, cotton ginning, cotton or jute pressing, decortication of groundnuts, the manufacture of coffee, indigo, lac, rubber, sugar (including *gur*) or tea or any manufacturing process which is incidental to or connected with any of the aforesaid processes."

The term Employee is defined in Section 2(9) of the Act as, "any person employed for wages in or in connection with the work of a factory or establishment to which this Act applies". The term includes persons working for an establishment through an intermediate

employer and also one whose services are temporarily lent or let on hire to an employer.

From the foregoing definitions it can be concluded that an insurable workman is a person who is employed, directly or indirectly, in an establishment to which the Act applies.

The following persons ~~are not insurable~~ and the Act confers no benefit on them :

- (i) Workers in seasonal factories.
- (ii) Workers in mines. (Separate provision has been made for mine-workers by the Mines Act, 1952, the Coal Mines Labour Welfare Fund Act, 1947 etc.).
- (iii) Workers in railway running sheds.
- (iv) Members of the naval, military and air forces of the Government.
- (v) Workmen whose total monthly remuneration exceeds Rs. 400.

Under Section 1 (5) the appropriate Government may extend the Act by notification to any establishment or class of establishment, industrial, commercial, agricultural or otherwise, subject to the approval of the Central Government and subject to giving six months' notice to such establishments.

THE EMPLOYEES' STATE INSURANCE CORPORATION

The administration of the scheme of insurance contained in the Act is vested in the Employees' State Insurance Corporation created by the Act. The Corporation consists of the following members ;

- (a) Two ex-officio members—the minister of Labour and the minister of Health in the Central Government; the former acts as the Chairman and the latter as the vice-Chairman of the Corporation.
- (b) The Central Government nominates 5 persons of whom at least 3 are officials of the Central Government. It also nominates one person to represent the Union territories. Each State Government, in whose territories the Act is in force, nominates one person. All these members hold office during the pleasure of the authority nominating them.
- (c) The Central Government nominates 5 persons to represent employers, 5 to represent employees and 2 to represent the medical profession. The nomination is to be made after consulting the appropriate association. These members hold office for four years.

- (d) Two persons are elected by the Parliament. They hold office for four years.

The Corporation can purchase, transfer and hold property, subject to such rules as may be framed about it. Sec. 29. Provision is made for the appointment of officers and staff and the allocation of their duties and functions. The Corporation is required to frame budget estimates for each year and submit the same for approval to the Central Government. It must keep proper accounts which will be audited by auditors appointed by the Central Government. A valuation of its assets and liabilities must be made at intervals of 5 years. The Corporation must submit to the Central Government an Annual Report of its work and activities. The annual report, the audited accounts and the budget as finally adopted must be placed before Parliament.

Section 19 provides that the Corporation may, in addition to the scheme of benefits specified in the Act, promote measures for the improvement of the health and welfare of insured persons and for the rehabilitation and re-employment of disabled and injured persons. For such measures, the Corporation can spend from the funds of the Corporation up to limits to be prescribed by the Government.

THE STANDING COMMITTEE

Section 8 provides for the creation of a Standing Committee from among the members of the Corporation. The Standing Committee is constituted as follows : a Chairman, nominated by the Central Government; 3 members nominated from the six officials of the Central Government; representatives of 3 of the State Governments; 2 members from the employers' representatives; 2 members from the employees' representatives; one member from the medical representatives; and one member from the representatives elected by the Parliament.

Section 18 provides that subject to the general superintendence and control of the Corporation, the Standing Committee shall administer the affairs of the Corporation and may exercise any of the powers and perform any of the functions of the Corporation. The Standing Committee shall submit for the consideration and decision of the Corporation such cases and matters as may be provided by regulations made in this behalf. The Committee may submit any other case or matter to the Corporation at its discretion.

The members of the Standing Committee hold office for different periods. Sec. 9.

MEDICAL BENEFIT COUNCIL

Section 10 provides for the creation of a Medical Benefit Council constituted as follows: (a) the Director General, Health Services, ex-officio chairman, (b) a Deputy Director-General, Health Services to be nominated by the Central Government; (c) the Medical Commissioner of the Corporation, ex-officio; (d) one member from each State in which the Act is in force, to be nominated by the State Government concerned; (e), (f), and (g) nine members to be nominated by the Central Government in consultation with the appropriate organisations—3 to represent employers, 3 the employees and 3 the medical profession (one of the medical members must be a woman). The Deputy-Director General, Health Services and the representatives of the State hold office during the pleasure of the Government. The other members hold office for a term of four years.

The powers and duties of the Medical Benefit Council are laid down in Section 22. The Council may—

- (a) advise the Corporation and the Standing Committee on matters relating to the administration of medical benefit, the certification for the purposes of the grant of benefits and other connected matters;
- (b) have such powers and duties of investigation as may be prescribed in relation to complaints against medical practitioners in connection with medical treatment and attendance; and
- (c) perform such other duties in connection with medical treatment and attendance as may be specified in the regulations.

CERTAIN GENERAL PROVISIONS

Certain general provisions regarding the Corporation, the Standing Committee and the Medical Benefit Council are enumerated below:

1. Outgoing members are eligible for re-election or re-nomination. Sec. 6.
2. A member may resign. Sec. 11.
3. A member ceases to be a member if he fails to attend three consecutive meetings. But he may be re-appointed. A member ceases to be a member if he ceases to represent the persons he was nominated to represent. Sec. 12.
4. A person is disqualified for being chosen or being a member if (a) he is declared to be of unsound mind by a

competent court; or (b) he is an undischarged insolvent; or (c) if he has directly or indirectly by, himself or by his partner any interest in any subsisting contract with, or any work being done for, the Corporation except as a medical practitioner or as shareholder (not director) of a company; or (d) if before or after the commencement of this Act, he has been convicted of an offence involving moral turpitude.

5. Members are entitled to receive fees and allowances as may be fixed by the Government. Sec. 15.
6. Meetings shall be held according to regulations. Sec. 20.
7. The Central Government may supersede the Corporation or the Standing Committee if it persistently makes default in performing its duties or abuses its powers. After supersession the Central Government may appoint new members or create an agency to exercise the powers and functions of these bodies. Sec. 21.

The Corporation may appoint Regional Boards, Local Committees and Regional and Local Medical Benefit Councils in such areas and in such manner and delegate to them such powers and functions as may be provided by the regulations. Sec. 25.

STATE INSURANCE FUND

All contributions paid and moneys received by the Employees' State Insurance Corporation are to be paid into a fund called the Employees' State Insurance fund. The Corporation is entitled to receive (i) contributions from employers (ii) contributions from employees and (iii) donations from the Central Government, the State Governments, local authorities etc. Sec. 26.

The Fund can be used for the payment of benefits, provision of medical treatment, payment of fees and salaries to the staff, maintenance of hospitals and other purposes authorised by the Corporation. Sec. 28.

CONTRIBUTIONS

In factories and establishments to which the Act applies, all employees must be insured. Insured employees and their employers are required to pay contributions to the Corporation on a weekly basis.

The amount of weekly contribution payable in respect of an employee is calculated with reference to his average daily wage. The

period in respect of which wages are ordinarily payable, by contract express or implied, or otherwise, is called the Wage Period. Where the wage period is a day, the average daily wage is the amount of wages earned in that wage period divided by the number of days worked in that period. For other wage periods, the average daily wage means the total wages earned in the period divided by the number of days worked. Where the employee works on any other basis, the average daily wages means the wages paid on the day the contribution falls due or such day as may be specified. Wages or allowances paid for leave or holidays are not to be taken into account except in cases provided for in the rules.

For the purpose of calculating the rates of contribution, employees are divided into eight classes. The rate for each class is given in Schedule I to the Act. They are as follows :—

<i>Average Daily Wage</i>	<i>Employee's Contribution</i>		<i>Employer's Contribution</i>	
	Rs.	As.	Rs.	As.
1. Below Re. 1	nil	0	7
2. Re. 1 and above but below Re. 1-8	0 2	0	7
3. Re. 1-8 and above but below Rs. 2	0 4	0	8
4. Rs. 2 and above but below Rs. 3	0 6	0	12
5. Rs. 4 and above but below Rs. 4	0 8	1	0
6. Rs. 4 and above but below Rs. 6	0 11	1	6
7. Rs. 6 and above but below Rs. 8	0 15	1	14
8. Rs. 8 and above	1 4	2	8

The employer is required to transmit to the Corporation both the employer's and the employee's contribution in the manner prescribed by the rules. The contribution payable by the employee can be deducted from his wages by the employer. But the contribution payable by the employer cannot be deducted from the wages of the employee.

Where there is a principal employer and an intermediate employer under him, the former is required to pay the contribution in the first instance. He may later on recover the money from the latter.

No contribution is payable by the employee if his average daily wage is less than Re. 1.

Contributions ordinarily fall due on the last day of the week.

Employers are required to furnish returns regarding the number of workmen employed and other particulars. The Corporation can appoint Inspectors for the purpose of inspecting the books and records of employers.

The aforesaid rules regarding contributions are contained in Sections 38 to 45 of the Act and Schedule I.

BENEFITS

The Act provides for five types of benefits to insured workmen: (a) Sickness Benefit (b) Maternity Benefit (c) Disablement Benefit (d) Dependants' Benefit and (e) Medical Benefit. Sections 46 to 59. Rules regarding the benefits are stated below.

1. **Sickness Benefit.** A person is entitled to receive sickness benefit in the form of cash if he has paid contribution for at least $2/3$ ds of the number of weeks in a contribution period, subject to a minimum of 12 contributions. A "Contribution Period" means a period not less than 25 but not more than 27 consecutive weeks or 6 consecutive months as may be specified in the regulations framed under the Act. The payment of the contributions during the Contribution Period entitles the workman to receive benefit during a subsequent period called the Benefit Period. The rate of benefit is laid down in Schedule II to the Act. It is roughly half the assumed average daily wage.

A person shall be able to get sickness benefit for a maximum period of 56 days in any contribution period of 365 days. No benefit is payable for the first two days of sickness except where the sickness follows within 15 days of a previous spell of sickness for which benefit was paid.

Sickness benefit is payable only for such sickness as is certified by the medical officer of the workman and which necessitates abstinence from work. If the sickness continues for more than 7 days the workman must obtain medical certificates at intervals of every 7 days.

2. **Maternity Benefit.** A woman worker is entitled to maternity benefit if she has paid certain contributions during the Contribution Period. The minimum number of contributions to be paid is the

same as that which is required for sickness benefit, except that one contribution should have been paid between 35 and 40 weeks before the week of confinement. An insured woman is entitled to maternity benefit at the rate of 12 annas a day for a period of 12 weeks of which not more than 6 weeks shall precede confinement. (This benefit is not in proportion to wages).

To obtain maternity benefit, the insured woman must get certificates of pregnancy, of the expected date of confinement and of actual confinement and send them to the Local Office to which she is attached.

3. Disablement Benefit. An injury may produce temporary disablement, permanent disablement or death. The permanent disablement may be either partial or total. A temporary disablement means a condition which requires medical treatment and which renders the employee temporarily incapable of work. In such cases the disabled person will be entitled to cash benefits at rates laid down in Schedule II. The rates are roughly half the assumed average daily wages of the employee for the period of 52 weeks immediately preceding the week in which the injury occurred. There is no condition of any previous contribution. The payment of benefit starts from the first day of incapacity and lasts as long as the temporary disablement continues. If the disablement is permanent and total, the disabled person is entitled to a benefit equal to what is payable for temporary disablement but such payment continues for life. If the permanent disablement is partial, the rate of benefit is proportional to the degree of disablement but continues for life. These benefits can be reviewed subsequently because the degree of disablement may change in course of time. An occupational disease is treated as an employment injury.

Notice of injury must be given to the employer by the injured employee or any of his friends or relatives. The employer is required to record the notice in an Accident Book to be kept by him and to send a report of the accident to the nearest Local Office of the Corporation and the nearest dispensary. The injured employee must obtain a medical certificate from the Medical Insurance Officer who attends him for treatment.

4. Dependants' Benefit. If an employee dies as a result of an injury his dependants are entitled to get benefit. The benefit is distributed as follows:

(a) To the widow during her life or until remarriage an amount equal to $\frac{3}{5}$ ths of the full rate (*i.e.* the rate at which the employee would have got benefit had he been alive with a temporary disablement). If there are two or more widows, the benefit is equally divided among them.

(b) To each legitimate or adopted son an amount equal to 2/5ths of the full rate until he attains 15 years of age.

(c) To each legitimate unmarried daughter an amount equal to 2/5ths of the full rate until she attains 15 years of age or is married, whichever is earlier.

If the sum-total of the benefits to the dependants distributed as above exceeds the full rate, the share of each dependant will be proportionately reduced, so that the total payment does not exceed the full rate of temporary disablement benefit.

If a person does not leave a widow or a legitimate child, the dependants' benefit shall be payable to a parent or grandparent or to other dependant children at such rates as may be decided by the Employees' Insurance Court.

For obtaining dependants' benefit, a claim must be submitted to the appropriate Local Officer, either jointly or severally by the dependants, in the prescribed form, together with the Death Certificate from the Medical Insurance Officer.

5. Medical Benefit. The Act provides that medical benefit may be given to an insured employee in the form of out-patient treatment (in a hospital, dispensary, clinic or any other institution) or by a visit at his home or as in-patient in a hospital or any other institution. Medical benefit may be extended to the family members of an insured person.

Arrangements for the provision of medical benefit under the Act will be made by the State Governments and the standard and scale of such benefits will be determined by agreement between the Corporation and the State Governments.

An insured person will be entitled to claim medical benefit during any week for which contributions are payable by him or in his behalf or for which he is qualified to claim sickness benefit or maternity benefit or during which he is in receipt of disablement benefit for temporary disablement. For obtaining medical benefit an employee must present himself at the appropriate dispensary with his identity card.

General Provisions Regarding Benefits. There are certain general provisions regarding benefit. They are enumerated below.

1. The right to receive any payment of any benefit is not transferable or assignable. No cash benefit is liable to attachment or sale in execution of a decree or order. Sec. 60.

2. A person entitled to receive a benefit under this Act shall not be entitled to receive benefit under any other Act. Sec. 61.

3. No person is entitled to receive sickness, maternity or disablement benefit for any day on which he works and receives wages. Sec. 63.

4. Recipients of sickness or disablement benefit must observe certain conditions *e.g.* remain under treatment and must not do anything which will retard their chances of recovery. Sec. 64.

5. Benefits of different kinds cannot be combined. If a person is entitled to receive more than one benefit he must choose which to receive. Sec. 65.

6. If an injury is caused by the negligence of the employer, the Corporation is entitled to receive compensation from the employer. Sec. 66.

7. Arrears of employers' contribution can be recovered as arrears of land revenue, with penalties in certain cases. Sec. 68.

8. Where the incidence of sickness among insured persons is excessive because of the neglect or non-observance of health regulations by the owner of a factory or of the residential place of the worker, the Corporation is entitled to receive compensation from such owner. The amount of such compensation is determined by a summary procedure under the regulation. Sec. 69.

9. Benefits improperly received by an insured person are repayable. Sec. 70.

10. An employer must not reduce, directly or indirectly, the wages of a workman on the ground that he is paying an insurance contribution. He must not reduce or discontinue any benefit which the workman was receiving under the contract of service except in cases provided for in the regulations. Sec. 72.

11. No employer can dismiss, discharge, reduce or otherwise punish an employee during the period he is receiving sickness benefit, maternity benefit or a temporary disablement benefit. Sec. 73.

EMPLOYEES' INSURANCE COURT

The Act empowers the State Governments to establish Courts for the purpose of deciding questions and disputes arising from the insurance of workmen. Such courts are known as Employees' Insurance Courts.

MISCELLANEOUS PROVISIONS OF THE ACT

1. The Act provides penalties for violating the provisions of the Act (*e.g.* failing to pay contributions, making false statements etc.). Sections 84-86.

2. A factory, or establishment or a class of factories or establishments can be exempted from the operation of the Act. This can be done by the appropriate Government by notification for one year at a time. Sec. 87.

3. The appropriate Government can similarly exempt any persons or class of persons employed in a factory or class of factory from the operation of the Act. Sec. 88.

4. The Central Government can give directions to the State Governments as to the carrying into execution of this Act in any State. Sec. 92.

5. Contribution and other payments due under this Act are deemed to be included in the list of debts which have priority over other debts in case of insolvency or winding up. Sec. 94.

6. At any time when its funds so permit, the Corporation may enhance the scale of any benefit admissible under the Act and the period for which such benefit may be given and provide or contribute towards the cost of medical care for the families of insured persons. Sec. 99.

CHAPTER 5

WORKMEN'S COMPENSATION ACT

OBJECT AND SCOPE

The Workmen's Compensation Act (Act VIII of 1923) came into force from 1st July, 1924. It applies to the whole of India except the State of Jammu and Kashmir. The Act provides for the payment of compensation, by certain classes of employers to their workmen, for injury by accidents.

Prior to the Workmen's Compensation Act, the employer was liable to pay compensation only if he was guilty of negligence. Even in cases of proved negligence, the employer could get rid of his liability by using any of the following defences :

(i) *The Doctrine of Assumed Risks.* If the employee knew the nature of the risks he was undertaking when working in a factory, the employer had no liability for injuries. The court assumed in such cases that the workman had voluntarily accepted the risks incidental to his work. The doctrine followed from the rule *Volenti Non Fit Injuria*, which means that one, who has volunteered to take a risk of injury, is not entitled to damages if injury actually occurs.

(ii) *The Doctrine of Common Employment.* Under this rule, when several persons work together for a common purpose and one of them is injured by some act or omission of another, the employer is not liable to pay compensation for the injury.

(iii) *The Doctrine of Contributory Negligence.* Under this rule, a person is not entitled to damages for injury if he was himself guilty of negligence and such negligence contributed to the injury.

The three aforesaid defences and the rule "no negligence, no liability" made it almost impossible for an employee to obtain relief in cases of accident. The Workmen's Compensation Act of 1923 radically changed the law. According to this Act, the employer is liable to pay compensation irrespective of negligence. The Act looks upon compensation as relief to the workman and not as damages payable by the employer for a wrongful act or tort. Hence contributory negligence by the employee does not disentitle him from relief. For the same reason, it is not possible for the employer to plead the defence of common employment or assumed risks for the purpose of avoiding lia-

bility. Thus the Act makes it possible for the workman to get compensation for injuries, unimpeded by the legal obstacles set up by the law of Torts.

Suits by workmen for damages: An injured workman may, if he wishes, file a civil suit for damages against the employer. Section 3 (5) of the Workmen's Compensation Act, however, provides that if such a suit is filed, compensation cannot be claimed under the Act and if compensation has been claimed under the Act, or if an agreement has been entered into between the employer and the workman for the payment of compensation, no suit can be filed in the civil court. Thus the workman has to choose between two reliefs (i) civil suit for damages and (ii) claim for compensation under the Act. He cannot have both.

In a civil suit for damages, it is open to the employer to plead all the defences provided by the law of Torts. Therefore, a civil suit is a risky procedure for a workman and is rarely adopted. The legal position of workmen has, however, been improved by two Acts, *viz.*, The Indian Fatal Accidents Act of 1855 and the Employers' Liability Act of 1938. The provisions of these Acts are summarised below.

The Indian Fatal Accidents Act. (Act XIII of 1855). This Act provides that when the death of a person is caused by wrongful act, neglect or default, a suit for damages can be brought by the executors, administrators or legal representatives of the deceased. Such a suit must be for the benefit of the wife, husband, parent and child, if any, of the deceased. The object of the Act is to avoid in such cases the operation of the rule, *actio moritallis moritur cum persona*, which means that, "a personal action dies with the death of the claimant".

The Employers' Liability Act. (Act XXIV of 1938) This Act declares that certain defences shall not be raised in suits for damages in respect of injuries sustained by a workman. Section 3 of the Act provides that the defence of common Employment cannot be pleaded when personal injury is caused under any of the following circumstances :

(a) the omission of the employer (or of anybody in his service) to maintain in good and safe condition any way, works, machinery or plant connected with or used in his trade or business;

(b) the negligence of any person in the service of the employer who has been entrusted with any superintendence;

(c) the negligence of any person in the service of the employer to whose order and direction the workman had to conform and did conform; or

(d) any act or omission of any person in the service of the employer done or made (i) in the normal performance of his duties (ii) in obedience to any rule or bye-law of the employer, or (iii) in obedience to any particular instructions given by any person to whom the employer has delegated authority in that behalf.

Section 3A makes void any agreement by which the provisions of Section 3 are contracted out.

Section 4 provides that in any suit for damages, the workman shall not be deemed to have undertaken any risk attaching to his employment unless the employer proves that the risk was fully explained to and understood by the workman and that the workman voluntarily undertook the same.

DEFINITIONS

Dependant. Section 2 (d) gives a long list of persons who come within the category of "dependant" of a workman. In ordinary language the dependant of a person is one who lives on his earnings. Under Section 2 (d) there are *three* categories of dependants.

(i) The following relations are dependants, whether actually so or not—widow, minor legitimate son, unmarried legitimate daughter, a widowed mother. Sub-sec. (i).

(ii) The following relations come within the category if any were *wholly* dependent on the earnings of the deceased workman at the time of his death—a son or daughter who has attained the age of 18 years and who is infirm. Sub-sec. (ii).

(iii) The following relations are dependants if they were *wholly* or *partly* so at the time of the workman's death—widower; parent, other than widowed mother; minor illegitimate son; unmarried illegitimate daughter; minor daughters, legitimate or illegitimate, married or widowed. Sub-sec. (iii).

The definition of dependant given above was inserted by an amendment made in 1959.

Employer. Sec. 2 (e) provides that the term Employer "includes" the following: (i) any body of persons whether incorporated or not (ii) any managing agent of an employer (iii) the legal representatives of a deceased employer, and (iv) any person to whom the services of a workman are temporarily lent or let out, while the workman is working for him. The definition is not exhaustive.

Examples:

- (i) The Government hired out some lorries with drivers to a contractor. Held, the contractor was the employer of the

lorry drivers within the meaning of the Act. *Krishna Aiyar v. The Superintending Engineer, P.W.D., Madras*.¹

- (ii) The owner of a boat hired it out to another. The latter engaged the crew. One of the crew died while on duty. The widow of the deceased claimed compensation from the owner of the boat. Held, he was not the employer and not liable to pay compensation. *Malenu v. Narasama*.²

Partial Disablement. Disablement, in ordinary language, means loss of capacity to work or move. Such incapacity may be partial or total and accordingly there are two types of disablement, partial and total. In the Act both types of disablement are further subdivided into two classes, temporary and permanent. By Section 2 (g) Temporary Partial Disablement means such disablement as reduces the earning capacity of a workman in *any employment in which he was engaged* at the time of the accident, and Permanent Partial Disablement means such disablement as reduces his earning capacity *in every employment he was capable of undertaking* at that time. The type of disablement suffered is to be determined from the facts of the case. But it is provided that every injury specified in Schedule I to the Act shall be deemed to result in permanent partial disablement. The schedule also mentions the percentage loss of earning capacity which is to be presumed in each such case.

Examples: (From Schedule I)

Description of Injury	Percentage loss of earning capacity		
Loss of both hands 100
Severe facial disfigurement 100
Absolute deafness 100
Loss of thumb 30
Loss of one eye 40
Middle finger of left hand (whole) 14

(There are 54 items listed in the Schedule, with percentage loss of earning capacity for each item mentioned.)

Total Disablement. According to Section 2 (1) total disablement means such disablement, whether of a temporary or permanent nature, as incapacitates a workman for all work which he was capable of performing at the time of the accident resulting in such disablement; provided that permanent total disablement shall be deemed to result

¹ I. L. R. (1949) Mad 578

² (1951) M. W. N. 807

from the permanent total loss of the sight of both eyes or from any combination of injuries specified in Schedule I, where the aggregate percentage of the loss of earning capacity as specified in that schedule against those injuries, amounts to one hundred per cent.

Wages. Wages include any privilege or benefit which is capable of being estimated in money, other than a travelling allowance or the value of any travelling concession or a contribution paid by the employer of a workman towards any pension or Provident Fund or a sum paid to a workman to cover any special expenses entailed on him by the nature of his employment. Sec. 2 (m).

The definition of wages is important because an employee whose monthly wages exceed Rs. 400 is not a workman for the purposes of the Act.

Share of profits or a bonus is wages under this Act, *Chitra Tanti v. Tata Iron & Steel Co.*³ Payments made by third parties, e.g. by customers to waiters in restaurants are not wages.

Section 5 of the Act defines "monthly wages" and states the methods of calculating it. "Monthly" wages means the amount of wages deemed to be payable for a month's service (whether the wages are payable by the month or by whatever other period or at piece rates). Monthly wages are calculated as follows:

(a) Where the workman was in service for a continuous period of 12 months immediately preceding the accident, monthly wages shall be one-twelfth of the total wages due for the last twelve months of the period.

(b) Where the whole of the period of continuous service was less than one month, monthly wages shall be the average monthly amount which during the twelve months immediately preceding the accident was being earned by a workman employed on the same work by the same employer, or if there was no workman so employed, by a workman employed on similar work in the same locality.

(c) In other cases, including cases in which it is not possible for want of necessary information to calculate the monthly wages under clause (b) the monthly wages shall be thirty times the total wages earned in respect of the last continuous period of service immediately preceding the accident from the employer who is liable to pay compensation, divided by the number of days comprising such period.

A period of service is deemed to be continuous which has not been interrupted by a period of absence exceeding 14 days

Workman. The definition of the term workman is important because only a person coming within the definition is entitled to the

³ A. I. R. (1946) Pat 437

reliefs provided by the Workmen's Compensation Act. "Workman" is defined in Section 2 (n) read with Schedule II to the Act.

In Schedule II, a long list (consisting of 32 items) is given of persons who come within the category of workmen. *Examples*: Persons employed otherwise than in a clerical capacity or in a railway to operate or maintain a lift or a vehicle propelled by steam, electricity or any mechanical power; persons employed otherwise than in a clerical capacity in premises where a manufacturing process is carried on; seamen in ships of a certain tonnage; persons employed in constructing or repairing buildings or electric fittings; persons employed in a circus or as a diver; etc.

Subject to the exceptions noted below, the term workman means,

(i) a railway servant as defined in Section 3 of the Indian Railways Act of 1890 who is *not* permanently employed in any administrative, district or sub-divisional office of a railway and *not* employed in any capacity as is specified in Schedule II or

(ii) employed on monthly wages not exceeding Rs. 500 in any such capacity as is mentioned in Schedule II.

The contract of employment may be expressed or implied, oral or in writing.

The Act provides that the following categories of persons are *not* to be deemed as workmen for the purposes of the Act:

(a) Persons working in the capacity of a member of the Armed Forces of the Union.

(b) A person whose employment is of a *casual nature* and who is employed otherwise than for the purposes of the employer's trade or business.

The exercise and performance of the powers and duties of a local authority or of any department acting on behalf of the Government shall, for the purposes of the Act, unless a contrary intention appears, be deemed to be the trade or business of such authority or department.

The State Government has been given power to add to the list in Schedule II any hazardous occupation or specified injuries in such an occupation. The addition may be made by notification in the official Gazette, with not less than 3 months' notice.

There is a large body of case law regarding the question who is a workman. The general rule is that there must be the relationship of master and servant between the employer and the workman. *Smith v. General Motor Cab Co.*⁴ Workman is a person whom the employer can command and control in the manner of performing the work.

⁴ (1911) A.C. 188

*Yewens v. Noakes*⁵. According to Willis,⁶ the following points are to be taken into consideration in determining the question whether a person is a workman: (a) the term of engagement (b) the payment of wages (c) the power of control over the work (d) the power to dismiss.

What is employment of a casual nature? Employees of a casual nature, if not employed in the employer's trade or business, do not come within the definition of the term workman as used in the Act.

Generally speaking, casual work is one which is not regular or continuous. A person doing odd jobs was employed by the occupier of a private premises to clean windows. Held, his work was of a casual nature. *Hill v. Begg*.⁷ A person officiating in a leave vacancy is not a casual worker. *In the matter of Alam Singh*.⁸

Whether the employment is for the purpose of the employer's trade or business depends on whether the contract of service entered into by the employer was in his capacity as a businessman or in a private capacity. When a coal mine owner employs workers to dig for coal, it is for his trade or business. But a coal mine owner engaging workers for building his residence, is not engaging them for his trade or business.

A person who does service which is illegal and void cannot be a workman and cannot claim compensation. *Kemp v. Lewis*.⁹

RULES REGARDING WORKMEN'S COMPENSATION

When is employer liable to pay compensation? Section 3 (1) lays down that if personal injury is caused to a workman by accident arising out of and in course of employment, his employer shall be liable to pay compensation.

From the above it follows that the employer is liable when (a) injury is caused to a workman by *accident* and (b) the accident arises *out of and in course of employment*. An occupational disease is deemed to be an injury by accident and the employer is liable to pay compensation. The section itself provides that in certain cases of injury, no compensation is payable. These cases are explained below.

What is an accident? Lord Macnaughten in *Fenton v. Thorley & Company*,¹ defined an accident as "an unlooked for mishap or un-

⁵ (1880) 6 Q.B.D. 530

⁶ Willis' Workmen's Compensation Act.

⁷ (1908) 2 K.B. 802

⁸ A.I.R. (1936) All 690

⁹ (1914) 3 K.B. 543

¹ (1903) A.C. 443

toward event which is not expected or designed." Thus a self-inflicted injury is not an accident ordinarily. In *Grime v. Fletcher*,² a person became insane as a result of accident and then committed suicide. It was held that death was the result of the accident and compensation was awarded. But where insanity was not the direct result of the accident compensation cannot be awarded, e.g., where suicide was due to brooding over the accident. *Withers v. L.B. & S.C. Railways*.³ A series of tiny accidents, each producing some unidentifiable result and operating cumulatively to produce the final condition of injury, would constitute together an accident to furnish a proper foundation for a claim under the Act. *Chillu Kahar v. Burn & Co. Ltd.*⁴ following *Burrell & Sons Ltd. v. Savage*.⁵

Personal Injury: Injury includes psychological and physiological injury such as nervous shock, insanity etc. *Yates v. South Kirkby Collieries*.⁶ The injury must be personal. An injury to the belongings of a workman does not come within the Act.

Arising out of and in the course of employment: This phrase has been copied from the English Act on the subject. The phrase has been interpreted in a large number of cases, English and Indian. But difficulties still remain.

In the course of employment: This part of the phrase covers the period of time during which the employment continues. Compensation is payable if the accident occurs within the 'period of employment. Generally speaking employment commences when the employee reaches his place of work and ceases when he leaves the place. But there are several exceptions to the above rule.

(1) When the workman uses transport provided by the employer for the purpose of going to and from the place of work, the time during which he uses the transport, is included in the course of his employment. *Holmes v. Great Northern Railway*.⁷

(2) The time during which the workman is upon the premises of the employer should be included in the period of employment. An employee of the E.I. Railway was knocked down and killed by a train while returning from duty by crossing the platform area. Held, the accident arose out of and in course of employment. *Ranibala Seth v. East Indian Railway*.⁸

² (1915) 1 K.B. 734

³ (1916) 2 K.B. 772

⁴ A.I.R. (1953) Cal. 516

⁵ 126 L.T.R. 49 H.L.

⁶ (1910) 2 K.B. 538

⁷ (1900) 2 Q.B. 409

⁸ A.I.R. (1951) Cal. 501

(3) If the workman reaches the place of employment before the time when the employment begins, if it was necessary and not too early, or if at the time of accident he was doing something to equip himself for the work, he is in course of employment. *Sharp v. Johnson*.⁹

(4) If the workman with the knowledge and permission of the employer lives at some distance from the place where he is called upon to work and if in the course of proceeding at a reasonable time and in a reasonable manner from his place to the place of work, he meets with a fatal accident then his accident must be held to arise out of and in course of employment. *Vishram v. Dadabhoy*.¹

(5) The period of rest during the period of employment is in the course of employment. But if the workman goes outside the employer's premises during the rest period and meets with an accident, it is not in course of employment. *Pruce v. Davey*.²

Arising out of the employment: In *Dennis v. White*,³ it was observed that, "When a man runs a risk incidental to his employment and is thereby injured, then the injury arises out of the employment." In *L & Y Railway v. Highley*,⁴ Lord Sumner set the test as follows: "Was it a part of the injured person's employment to hazard, to suffer or to do that which caused his injury? If yea, the accident arose out of his employment, if nay, it did not." The dictum of Lord Sumner was followed in several Indian cases, e.g., *Sheikh Nawab Ali v. Sree Hanuman Jute Mills*.⁵

Occupational Diseases. Persons employed in certain occupations are liable to be attacked by certain diseases. For example, a person engaged in an employment involving exposure to dust containing silica is liable to contract silicosis, telegraph operators are liable to have what is called Telegraphist's Cramp. Such diseases are known as Occupational Diseases. Schedule III to the Workmen's Compensation Act contains a list of occupational diseases divided into three parts, Part A, Part B and Part C. Part A includes Anthrax, Compressed Air Sickness, Poisoning by lead tetra-ethyl and nitrous fumes. Part B includes, poisoning by lead compounds, phosphorus, mercury etc.,

⁹ (1905) 2 K.B. 139

¹ A.I.R. (1942) Bom. 175

² (1926) 20 B.W.C.C. 237

³ (1917) A.C. 479

⁴ (1917) A.C. 352

⁵ A.I.R. (1933) Cal. 513

See F.N. Ball, "Statute Law relating to Employment" for a classification of cases on this point.

cancer of the skin, telegraphist's cramp etc. Part C includes Silicosis, Asbestosis etc.

Section 3 (2) of the Act provides that an occupational disease, "shall be deemed to be an injury by accident within the meaning of this section and, unless the contrary is proved, the accident shall be deemed to have arisen out of, and in the course of, the employment."

For diseases included in Part A of Schedule III, the employer is liable to pay compensation when a workman employed by him contracts the disease. For the diseases included in Part B, the employer is liable if a workman contracts it while in his service and if the workman has been in his service for a continuous period of six months, which period shall not include a period of service under any other employer in the same kind of employment. For diseases included in Part C of Schedule III, the workman is entitled to compensation if he has been in the service of one or more employers for such continuous period as the Central Government may specify. In this case, the compensation is to be paid by all the employers in such proportions as the Commissioner of Workmen's Compensation may deem just.

The list of occupational diseases and the employments producing them as contained in Schedule III may be extended (by notification) by the State Government in the case of Parts A and B and by the Central Government in the case of Part C.

Section 3 (4) lays down that save as provided above, no compensation shall be payable to a workman in respect of any disease unless the disease is directly attributable to a specific injury by accident arising out of, and in the course of his employment.

When is employer not liable to pay compensation? Section 3 of the Act provides that the employer is not liable to pay compensation in the following cases :

(a) in respect of any injury which does not result in the total or partial disablement of the workman for a period exceeding three days ;

(Formerly the period was seven days. By an amendment made in 1959, the period has been reduced from seven to three.)

(b) in respect of any injury, not resulting in death, caused by an accident which is directly attributable to—

- (i) the workman having been at the time thereof under the influence of drink or drugs, or,
- (ii) the wilful disobedience of the workman to an order expressly given, or to a rule expressly framed, for the purpose of securing the safety of workmen, or

- (iii) the wilful removal or disregard by the workman of any safety guard or other device which he knew to have been provided for the purpose of securing the safety of workmen.

The Amount of Compensation. For determining the amount of compensation payable under the Act, Section 4 has to be read with Schedule IV to the Act. In Schedule IV, there is a table having four columns. The first column gives the possible monthly wages earned by the injured workman, divided under 18 heads. The amount payable for death or permanent total disablement to workmen of each group is mentioned in the corresponding entry in column 2 and column 3 respectively. Column 4 gives the amount of half monthly payment to be made for temporary disablement. Schedule IV is reproduced below.

SCHEDULE IV				
Compensation payable in certain cases				
<i>Vide The Workmen's Compensation Amendment Act, (Act 64 of 1962)</i>				
<i>Monthly Wage of the Workman Injured</i>		<i>Amount of Compensation</i>		<i>Half-monthly Payment for</i>
<i>More than</i>	<i>Not more than</i>	<i>Death</i>	<i>Permanent Total Disablement</i>	<i>Temporary Disablement</i>
Rs.	Rs.	Rs.	Rs.	Rs. nP.
0	10	1,000	1,400	Half his monthly wage
10	13	1,100	1,540	Do
13	18	1,200	1,680	6.50
18	21	1,260	1,764	7.00
21	24	1,440	2,016	8.00
24	27	1,620	2,268	8.50
27	30	1,800	2,520	9.50
30	35	2,100	2,940	9.50
35	40	2,400	3,360	10.00
40	45	2,700	3,780	13.00
45	50	3,000	4,200	13.00
50	60	3,600	5,040	18.50
60	70	4,200	5,880	18.50
70	80	4,800	6,720	20.00
80	100	6,000	8,400	26.00
100	150	7,000	9,800	37.50
150	200	7,000	9,800	52.50
200	300	8,000	11,200	60.00
300	400	9,000	12,600	75.00
400	—	10,000	14,000	87.50

The rules regarding the amount of compensation, as laid down in Section, 4, are stated below:

For Death : The employer must pay the amount mentioned in column 2 of Schedule IV.

For Permanent Total Disablement : The employer must pay the amount mentioned in column 3 of Schedule IV.

For Permanent Partial Disablement : Schedule I to the Act contains a list of injuries deemed to result in permanent partial disablement together with the percentage loss of earning capacity which is presumed to occur in each case. When permanent partial disablement occurs from an injury specified in Schedule I, the amount of compensation is to be calculated by finding out from Schedule IV the compensation payable for permanent total disablement to the workman concerned and multiplying it with the percentage loss of earning capacity as stated in Schedule I. Thus, suppose that there in an injury which, according to Schedule I, causes a 30% loss of earning capacity. Suppose that the monthly wage of the workman is Rs. 100. From Schedule IV it is seen that for permanent total disablement he would have obtained Rs. 4200. Hence for the permanent partial disablement he would get 30% of Rs. 4200, i.e., Rs. 1260.

In the case of an injury not specified in Schedule I, the percentage loss of earning capacity permanently caused must be found out. This figure multiplied by the amount of compensation for permanent total disablement gives the amount of compensation payable for the partial disablement.

Where more injuries than one are caused by the same accident, the amount of compensation payable under this head shall be aggregated but not so in any case as to exceed the amount which would have been payable if permanent total disablement had resulted from the injuries.

For Temporary Disablement : Where as a result of the injury there is a temporary disablement, total or partial, the employer is required to make a half-monthly payment to the workman. The rate of half-monthly payment is given in column 4 of Schedule IV. (There are different rates for different wage groups.)

Rules regarding Half-Monthly Payment : The first half-monthly payment is to be made on the sixteenth day (i) from the date of the disablement, where such disablement lasts for a period of 28 days or more, or (ii) after the expiry of a waiting period of three days from the date of the disablement, where such disablement lasts for a period of less than 28 days. Thereafter the payments must be made

half-monthly during the disablement or during a period of five years, whichever period is shorter.

From any lump sum payment made for compensation and from any half-monthly payment, any sum which the workman has received from the employer, prior to the receipt of the lump sum or half-monthly payment, may be deducted. But any sum received for medical treatment, cannot be so deducted. Sec. 4 (1) (a).

No half-monthly payment shall in any case exceed the amount, if any, by which half the amount of the monthly wages of the workman before the accident exceeds half the amount of such wages which he is earning after the accident. Sec. 4 (1) (b).

On the ceasing of the disablement before the date on which any half-monthly payment falls due, there shall be payable in respect of that half month a sum proportionate to the duration of the disablement in that half-month. Sec. 4 (2).

Any half-monthly payment payable to a workman may be reviewed by the Commissioner on the application of either the employer or the workman on the ground that there has been a change in the condition of the workman. The payment may upon review, be continued, increased, decreased or ended or (in case the injury has resulted in a permanent disablement) converted into a lump sum. Sec. 6.

A right to receive half-monthly payment may, by agreement or by order of the Commissioner, be redeemed by the payment of a lump sum. This is called commutation of half-monthly payments. Sec. 7.

Distribution of Compensation. Section 8 lays down the following rules regarding the distribution of compensation:

(1) Compensation for death and lump sum payment due to a woman or to a person under a legal disability must be deposited with the Commissioner. But in the case of a deceased workman, an employer may make to any dependant advances on account of compensation not exceeding an aggregate of one hundred rupees. So much of such aggregate as does not exceed the compensation payable to that dependant shall be deducted by the Commissioner from such compensation and repaid to the employer.

(2) Any other sum amounting to not less than Rs. 10 which is payable as compensation may be deposited with the Commissioner on behalf of the person entitled thereto.

(3) The receipt of the Commissioner shall be sufficient discharge in respect of any compensation deposited with him.

(4) After the deposit of the compensation, the Commissioner shall deduct therefrom the actual cost of the workman's funeral ex-

penses to an amount not exceeding Rs. 50 and pay the same to the person by whom the expenses were incurred. The Commissioner may serve notices calling upon the dependants to appear before him for the purpose of determining the distribution of the compensation. If the Commissioner is satisfied that no dependant exists, he shall repay the balance of the money to the employer. The Commissioner shall on application by the employer, furnish a statement showing in detail all disbursements made.

(5) The compensation money is to be distributed among the dependants in such proportions as the Commissioner thinks fit. The whole of it may be given to one person.

(6) Except in the case of a woman or a person under a legal disability, the compensation money is to be paid to the person entitled thereto.

(7) Money payable to a woman or a person under a legal disability may be invested or otherwise dealt with as the Commissioner thinks fit. Half-monthly payments payable to a person under a legal disability may be paid to a dependant of the workman or to any other person whom the Commissioner thinks best fitted to provide for the welfare of the workman.

(8) The orders of the Commissioner regarding the distribution of compensation may be varied later if necessary. Notice must be given to the parties affected.

(9) Where under the previous para, the Commissioner varies an order on the ground that the payment of compensation to any person has been obtained by fraud, impersonation or other improper means, any amount so paid may be recovered by the procedure laid down for the recovery of arrears of land revenue.

Other Provisions regarding Compensation.

Compensation shall be paid as soon as it falls due. Where the employer does not accept the liability to the extent claimed, he must make provisional payment based on the extent of liability which he accepts. This is without prejudice to the right of the workman to make any further claim. If an employer fails to pay the compensation within one month of the date on which it fell due, the Commissioner may direct the payment of simple interest thereon at 6%. If the Commissioner thinks that there is no justification for the delay, he may direct the payment of a further sum, not exceeding 50% of the sum due, by way of penalty. Sec. 4A.

Save as provided by this Act, no lump sum or half-monthly payment payable under the Act shall in any way be capable of being assigned or charged or be liable to attachment or pass to any person other than the workman by operation of law, nor shall any claim be set off against the same. Sec. 9.

Notice and Claim : Section 10 of the Act provides that no claim for compensation shall be entertained by the Commissioner unless notice of the accident has been given in the manner provided as soon as practicable. (This is subject to certain exceptions noted below.)

The required notice must be served upon the employer or upon any of several employers or upon any person responsible to the employer for the management of any branch of the trade or business in which the injured workman was employed. The notice shall give the name and address of the person injured, the cause of the injury and the date of the accident. The notice may be given by the injured workman or by anybody on his behalf. It may be served by delivering it or sending it by registered post. The State Government may require that any prescribed class of employers shall keep at the place of employment a notice-book (accessible to all workers or persons acting bonafide on their behalf) where the occurrence of accidents may be recorded. An entry in the notice book is sufficient notice.

The want of notice or any defect or irregularity in it shall not be a bar to a claim in the following cases:

(i) Where a workman dies of an accident occurring in the premises of the employer or while working under the control of the employer or of any person employed by him, and the workman died on the premises or without leaving the vicinity of the premises.

(ii) If the employer or any one of several employers or any person responsible to the employer for the management of any branch of the trade or business in which the injured workman was employed, had knowledge of the accident from any other source at or about the time when it occurred.

(iii) If the Commissioner is satisfied that the failure to give notice was due to sufficient cause.

Section 10 also provides that a claim for compensation must be preferred before the Commissioner within two years of the occurrence of the accident or the date of death as the case may be. In case the accident is the contracting of a disease the date of its occurrence is the first of the days during which the workman was continuously absent from work in consequence of the disablement caused by the disease. The Commissioner may entertain a claim, filed after the

prescribed time, if he is of opinion that the failure to file it within time was due to sufficient cause.

Fatal Accidents: Section 10A provides that where a Commissioner receives information that a workman has died as a result of an accident arising out of and in course of his employment, he may send by registered post a notice to the workman's employer requiring him to submit, within thirty days of the service of the notice, a statement in the prescribed form, giving the circumstances attending the death of the workman, and indicating whether, in the opinion of the employer, he is or is not liable to deposit compensation on account of the death. If the employer is of opinion that he is liable, he shall make the deposit within thirty days of the service of the notice. If he is of opinion that he is not liable, he must state his grounds. In the latter case, the Commissioner, after such enquiry as he may think fit, inform any of the dependants of the deceased workman that it is open to them to prefer a claim and may give them such further information as he may think fit.

Section 10B provides that where by any law for the time being in force, notice is required to be given to any authority by or on behalf of an employer, of any accident resulting in death or serious bodily injury, the person required to give the notice shall also send a report to the Commissioner. The report may be sent alternatively to any other authority prescribed by the State Government. The State Government may extend the scope of the provision requiring reports of fatal accidents to any class of premises. But Sec. 10B does not apply to factories to which the Employees' State Insurance Act applies.

Medical Examination: After a workman gives notice of an accident, the employer may, within three days of the service of the notice, offer to have him examined free of charge by a qualified medical practitioner. Any workman in receipt of half-monthly payments may also be required to submit himself for examination from time to time. The examination must be in accordance with the rules framed for the purpose. If the workman refuses, without sufficient cause, to submit to the examination or if he leaves the vicinity of the place in which he was employed, his right to receive compensation shall be suspended during the continuance of the refusal or until his return to the vicinity and examination. In case the workman, who refused medical examination, subsequently dies, the Commissioner has discretionary powers of direct payment of compensation to the dependants of the deceased workman. The condition of an injured workman may be aggravated by refusal to submit to medical examination or refusal to follow the instructions of the medical

examiner or failure to be attended by or follow the instructions of a qualified medical practitioner. In such a case he would get compensation, not for the aggravated injury, but what the injury would have been had he been properly treated. Sec. 11.

Employment by contractors: When an employer engages contractors who engage workmen, any workman injured may recover compensation from the employer if the following conditions are satisfied: (a) the contractor is engaged to do a work which is part of the trade or business of the principal (b) the engagement is in the course of or for the purposes of his trade or business, and (c) the accident occurred in or about the vicinity of the employer's premises. The workman may also proceed against the contractor. So he has alternative remedies. When the employer pays compensation, he is entitled to be indemnified by the contractor. Sec. 12.

Example :

A company was the sole selling agents of a mill. It appointed a firm of transport contractors to remove bales from the mill godown to its shop. The transport contractors hired a lorry from a lorry owner. A workman who was cleaner of the lorry was accidentally killed while removing bales. Held that the selling agents were liable to any compensation. *Bai Kokilabai v. Keshavlal Mangaldas & Co.*^o

Remedies of employer against stranger: Where a workman has recovered compensation in respect of any injury caused under circumstances creating a legal liability of some person other than the person by whom the compensation was paid and any person who has been called on to pay an indemnity under Section 12 shall be indemnified by the person so liable to pay damages as aforesaid. Sec. 13.

Insolvency of Employer: The liability to pay workmen's compensation can be insured against. If an employer, who has entered into a contract of insurance for this purpose, becomes insolvent or enters into a scheme of composition or arrangement or (being a company) is wound up, the rights of the employer as against the insurer shall be transferred to and vest in the workman. The liability to pay compensation to a workman is to be treated as a preferred debt under insolvency and winding up. For this purpose, the liability to pay half-monthly payments is to be taken as equivalent to the lump sum payment into which it can be commuted. This section does not apply where a company is wound up voluntarily merely for the purpose of reconstruction or amalgamation with another company. Sec. 14.

Transfer of Assets by Employer: Where an employer transfers his assets before any amount due in respect of any compensation, the liability wherefor accrued before the date of the transfer, has been

^o A.I.R. (1942) Bom. 18

paid, such amount shall, notwithstanding anything contained in any other law for the time being in force, be a first charge on that part of the assets so transferred as consists of immovable property. Sec. 14A.

Masters and Seamen : So far as masters and seamen are concerned, the provisions of the Act apply with certain modifications laid down in Section 15.

Returns : The State Government may, by notification in the official Gazette, direct employers to submit returns regarding compensation paid by them and particulars relating to the compensation. Sec. 16.

Contracting Out : Section 17 provides that any contract by which a worker relinquishes his right to receive compensation for injury is null and void in so far as it purports to remove or reduce the liability of any person to pay compensation under this Act.

Penalties : Section 18A provides for penalties for failure to perform the duties prescribed under the Act, *e.g.*, failure to send returns or maintain notice books etc.

COMMISSIONERS

The Act provides for the appointment of officers to be known as Commissioners of Workmen's Compensation. The Commissioners are to determine the liability of any person to pay compensation (including the question whether a person is or is not a workman) and the amount or duration of compensation (including any question as to the nature or extent of disablement). No civil court has jurisdiction to deal with matters which are required to be dealt with by a Commissioner. Certain powers have been given to the Commissioners, *e.g.*, the power to call for further deposits. The Commissioner has the powers of a Civil Court. An appeal lies to the High Court against certain orders of the Commissioner.

CHAPTER 6

TRADE UNIONS

The Indian Trade Unions Act (Act XVI of 1926) was passed to provide for the registration of Trade Unions and in certain respects to define the law relating to registered Trade Unions. The Act applies to the whole of India except the State of Jammu and Kashmir.

DEFINITION OF TRADE UNION

In ordinary language the term Trade Union means an association of workers. The Act, however, defines the term very broadly as follows. " 'Trade Union' means any combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers, or between workmen and workmen, or between employers and employers, or for imposing restrictive conditions on the conduct of any trade or business, and includes any Federation of two or more Trade Unions." Sec. 2 (h).

From the above it follows that a Trade Union may be temporary or permanent. A Trade Union may be formed for the purpose of regulating the relations between (i) workmen and employers or (ii) between workmen and workmen or (iii) between employers and employers. It may also be formed for the purpose of imposing restrictive conditions on the conduct of any trade or business. A Federation of Trade Unions also comes within the definition.

The Trade Unions Act does not affect—

- (i) any agreement between partners as to their own business ;
- (ii) any agreement between an employer and those employed by him as to such employment ; or
- (iii) any agreement in consideration of the sale of the goodwill of a business or of instruction in any profession, trade or handicraft.

REGISTRATION OF TRADE UNIONS

One of the objects of the Act is to provide for the registration of trade Unions. Section 3 provides that the appropriate Government shall appoint a person to be the Registrar of Trade Unions for each State.

By an amendment made in 1960 it is provided that the appropriate Government may also appoint Additional or Deputy Registrars of Trade Union and give them specified powers.

(The term appropriate Government means the Central Government in the case of Unions whose objects are not confined to one State and the State Government in other cases.)

Mode of registration : Any seven or more members of a Trade Union can apply for registration of the Trade Union. They must subscribe their names to the rules of the Trade Union. They must comply with the provisions of the Act relating to registration. Sec. 4.

Every application for registration shall be made to the Registrar and shall be accompanied with a copy of the rules of the Trade Union and a statement of the following particulars :

- (a) the names, occupations and addresses of the members making the application ;
- (b) the name of the Trade Union and the address of its head office ; and
- (c) the titles, names, ages, addresses and occupations of the officers of the Trade Union.

Where a Trade Union has been in existence for more than one year before the application for registration is made, the application must be accompanied with a general statement of the assets and liabilities of the Union prepared in the prescribed form. Sec. 5.

A Trade Union shall not be entitled to registration, unless the executive thereof is constituted in accordance with the provisions of the Act. Sec. 22. (See *post*).

Registration will be refused unless the rules of the Union provide for the following matters : Sec. 6.

- (a) the name of the Trade Union ;
- (b) the whole of the objects for which the Trade Union has been established ;
- (c) the whole of the purposes for which the general funds of the Trade Union shall be applicable ;

(Registration will be refused unless the purposes are in accordance with the rules laid down in Section 15. See below).

- (d) the maintaining of a list of members of the Trade Union and adequate facilities for the inspection thereof by the officers and members of the Trade Union ;
- (e) the admission of ordinary members who shall be persons actually engaged in an industry with which the Trade Union is connected, and also the admission of the number

of honorary or temporary members as officers required under Section 22 to form the executive of the Trade Union ;

- (ee) the payment of a subscription by members of the Trade Union which shall be not less than twenty-five *naye paise* per month per member ;

[This clause was added by The Indian Trade Unions (Amendment) Act, 1960.]

- (f) the conditions under which any members shall be entitled to any benefit assured by the rules and under which any fine or forfeiture may be imposed on the members ;
- (g) the manner in which the rules shall be amended, varied or rescinded ;
- (h) the manner in which the members of the executive and other officers of the Trade Union shall be appointed and removed ;
- (i) the safe custody of the funds of the Trade Union, an annual audit, in such manner as may be prescribed, of the accounts thereof, and adequate facilities for the inspection of the account books by the officers and members of the Trade Union ; and
- (j) the manner in which the Trade Union may be dissolved.

The Registrar may call for further information for the purpose of satisfying himself that the Trade Union complies with the provisions of Sections 5 and 6. If the information is not supplied, registration may be refused. Sec. 7 (1).

If the name under which the Trade Union is proposed to be registered is identical with the name of any other registered Union or resembles it, in the opinion of the Registrar, to such an extent as to be likely to deceive the public or members of either Union, the Registrar may require that the proposed name be altered. If such alteration is not made registration may be refused. Sec. 7 (2).

When the Registrar is satisfied that all requirements have been complied with, he shall register the Trade Union by entering its name and particulars in the Register. Sec. 8. He shall also issue a certificate of registration in the prescribed form. The certificate shall be conclusive evidence that the Trade Union has been duly registered under the Act. Sec. 9.

Example : A union named Inland Steam Navigation Workers' Union was refused registration on the ground that it was really a union (called the I.G.N. Union) which had been declared to be an unlawful body. It was held that the duties of the Registrar, under Section 8 of the Act, are to see whether the objects of the Union are in accordance

with the provisions of the Act and whether all the requirements of the Act have been complied with. If so, the Registrar has no other option but to register the Union. *In Re Inland Steam Navigation Workers' Union*.¹

Cancellation of Registration: Section 10 gives power to the Registrar to withdraw or cancel the certificate of registration under the following circumstances:

- (a) on the application of the Trade Union, verified in the prescribed manner, or
- (b) if the Registrar is satisfied that the certificate has been obtained by fraud or mistake, or that the Trade Union has ceased to exist or has wilfully and after notice from the Registrar contravened any provision of the Act or allowed any rule to continue in force which is inconsistent with any such provision, or has rescinded any rule providing for any matter required to be provided by Section 6.

In cases coming under (b) two months' previous notice in writing must be given.

If registration is refused or if the certificate of registration is withdrawn or cancelled, the Union can appeal to the Court. Where the registered office of the Union is situated in a Presidency Town, the appeal lies to the High Court. In other cases, it lies to such court, not inferior to the court of an additional or assistant judge of a principal Civil Court of original jurisdiction, as the appropriate Government may appoint. Sec. 11.

Certain Acts not to apply: The following Acts do not apply to a registered union, viz., (i) The Societies Registration Act, 1860 (ii) The Co-operative Societies Act, 1912 and (iii) The Indian Companies Act. The registration of any such union under any such Act is void.

RIGHTS AND PRIVILEGES

A registered Trade Union (and its members) have been given certain rights and privileges. They are enumerated below.

1. *Incorporation*: Every registered Trade Union shall be a body corporate by the name under which it is registered, and shall have perpetual succession and a common seal with power to acquire and hold both movable and immovable property and to contract and shall by the said name sue and be sued. Sec. 13.

2. *Immunity from criminal prosecution*: No officer or member of a registered Trade Union shall be liable to punishment under

subsection (2) of section 120B of the Indian Penal Code, in respect of any agreement made between the members for the purpose of furthering any such object of the Trade Union as is specified in Section 15, unless the agreement is an agreement to commit an offence. Sec. 17.

Section 120B (2) of the Indian Penal Code provides for punishment for the offence of criminal conspiracy. Section 17 of the Trade Unions Act gives immunity to registered Trade Unions from criminal conspiracy in connection with trade disputes. The term trade dispute is defined in Section 2 (g) as follows :

“Trade dispute” means any dispute between employers and workmen or between workmen and workmen, or between employers and employers which is connected with the employment or non-employment, or the terms of employment or the conditions of labour of any person, and “workmen” means all persons employed in trade or industry whether or not in the employment of the employer with whom the trade dispute arises.

3. *Immunity from Civil Suit in certain cases* : No suit or other legal proceeding shall be maintainable in any Civil Court against any registered Trade Union or any officer or member thereof in respect of any act done in contemplation or furtherance of a trade dispute to which a member of the Trade Union is a party on the ground only that such act induces some other person to break a contract of employment of some other person or with the right of some other person to dispose of his capital or of his labour as he wills. Sec. 18 (1).

A registered Trade Union shall not be liable in any suit or other legal proceeding in any Civil Court in respect of any tortious act done in contemplation or furtherance of a trade dispute by an agent of the Trade Union if it is proved that such person acted without the knowledge of, or contrary to express instructions given by, the executive of the Trade Union. Sec. 18 (2).

4. *Enforceability of Agreements* : Notwithstanding anything contained in any other law for the time being in force, an agreement between the members of a registered Trade Union shall not be void or voidable merely by reason of the fact that any of the objects of the agreement are in restraint of trade :

Provided that nothing in this section shall enable any Civil Court to entertain any legal proceeding instituted for the express purpose of enforcing or recovering damages for the breach of any agreement concerning the conditions on which any members of a Trade Union shall

or shall not sell their goods, transact business, work, employ, or be employed. Sec. 19.

5. *Right to inspect books* : An officer or member of the Union can inspect the account books of the Union at such times as may be provided for by the rules of the Union. Sec. 20.

6. *Rights of minors to be member* : Subject to any rule of the Union to the contrary, any person who has attained the age of fifteen years may be a member of a registered Trade Union and enjoy all the privileges of such membership. But no person can be an officer of the Union unless he has attained the age of eighteen years. Sec. 21.

7. *Change of Name* : The name of a registered Trade Union may be changed (i) if two-thirds of the total number of members agree and (ii) if the proposed new name is not identical with that of any existing registered Union and does not, in the opinion of the Registrar, resemble any such name so nearly as to be likely to deceive the public or members of either union. Notice in writing of the change of name, signed by the secretary and seven members must be sent to the Registrar. The Registrar shall register the change if satisfied that the provisions of the Act have been complied with. The change takes effect from the date of registration. The change in name does not affect any right or obligation of the Trade Union or render defective any legal proceeding by or against the Trade Union, and any legal proceeding which might have been continued or commenced by or against it by its former name may be continued or commenced by or against it by its new name. Sections 23, 25 and 26.

8. *Amalgamation of Unions* : Any two or more registered Trade Unions may become amalgamated together as one Trade Union, with or without dissolution or division of the funds of such Trade Unions or either or any of them provided that the votes of at least one-half of the members of each or every such Trade Union entitled to vote are recorded and that at least sixty percent of the votes recorded are in favour of the proposal. Notice in writing of the amalgamation, signed by the secretary and seven members of each and every Trade Union which is a party thereto shall be sent to the Registrar of each of the States in which any of the amalgamated unions had a registered office. The Registrar of the State in which the head office of the amalgamated Union is situated shall register it if satisfied that all the provisions of the Act have been complied with. The amalgamation takes effect from the date of registration. An amalgamation of two or more Unions does not prejudice any right of any of the Trade Unions or any right of a creditor of any of them. Sections 24, 25 and 26.

DUTIES AND LIABILITIES

The Act imposes certain duties and liabilities on registered Trade Unions. They are enumerated below.

1. *Change of registered office* : If the address of the head office of a Trade Union is changed, notice in writing must be given to the Registrar within fourteen days of the change. The change shall be recorded in the Register. Sec. 12.

2. *Objects on which general funds may be spent* : Section 15 provides that the general funds of a registered Trade Union shall not be spent on any object other than the following :

- (a) the payment of salaries, allowances and expenses to officers of the Trade Union ;
- (b) the payment of expenses for the administration of the Trade Union, including audit of the accounts of the general funds of the Trade Union ;
- (c) the prosecution or defence of any legal proceeding to which the Trade Union or any member thereof is a party, when such prosecution or defence is undertaken for the purpose of securing or protecting any rights of the Trade Union as such or any rights arising out of the relations of any member with his employer or with a person whom the member employs ;
- (d) the conduct of trade disputes on behalf of the Trade Union or any member thereof ;
- (e) the compensation of members for loss arising out of trade disputes ;
- (f) allowances to members or their dependants on account of death, old age, sickness, accidents or unemployment of such members ;
- (g) the issue of, or the undertaking of liability under, policies of assurance on the lives of members, or under policies insuring members against sickness, accident or unemployment ;
- (h) the provision of educational, social or religious benefits for members (including the payment of the expenses of funeral or religious ceremonies for deceased members) or for the dependants of members ;
- (i) the upkeep of a periodical published mainly for the purpose of discussing questions affecting employers or workmen as such ;

- (j) the payment, in furtherance of any of the objects on which the general funds of the Trade Union may be spent, of contributions to any cause intended to benefit workmen in general, provided that the expenditure in respect of such contributions in any financial year shall not at any time during that year be in excess of one-fourth of the combined total of the gross income which has up to that time accrued to the general funds of the Trade Union during that year and of the balance at the credit of those funds at the commencement of that year; and
- (k) subject to any conditions contained in the notification any other object notified by the appropriate Government in the official Gazette.

3. *The Political Fund*: Section 16 empowers a registered Trade Union to constitute a separate Fund to be used for political purposes. Contributions to the Political Fund must be separately collected on a voluntary basis. No member can be compelled to contribute. No member can be excluded from any benefit or deprived of any privilege by reason of his not contributing to it. The Political Fund can be used for the following purposes:

(a) The payment of any expenses incurred, directly or indirectly, by a candidate or prospective candidate for election to a legislative body under the Constitution or to a local body. The expenses might have been incurred before, after or during the election.

(b) The holding of any meeting or the distribution of any literature or documents in support of such a candidate.

(c) The maintenance of a person who is a member of a legislative body under the Constitution or of a local body.

(d) The registration of electors or the selection of a candidate for election to a legislative body under the Constitution or a local body.

(e) The holding of political meetings of any kind or the distribution of political literature or political documents of any kind.

4. *Proportion of officers to be connected with the industry*: Not less than one-half of the total number of the officers of every registered Trade Union shall be persons actually engaged or employed in an industry with which the Trade Union is connected. The appropriate Government may by a special or general order exempt any Union or class of Unions from this provision. Sec. 22.

5. *Dissolution*: A registered Trade Union may be dissolved according to the rules of the Union. Notice of the dissolution must be given signed by the Secretary and seven members within fourteen days of the dissolution. The dissolution takes effect from the date

it is registered. If the rules of the Union do not provide how the funds of the Union shall be distributed, the Registrar shall distribute the funds among the members in the manner prescribed by the rules framed under the Act. Sec. 27.

6. *Returns* : Section 28 provides as follows :

(1) By a prescribed date, every registered Trade Union must send to the Registrar a general statement showing its receipts and expenditure during the year ending 31st March of the previous year audited in the prescribed manner. It must also send a statement of assets and liabilities existing on the 31st March.

(2) Along with the aforesaid statements must be sent a statement showing all changes of officers made during the aforesaid year and a copy of the rules of the Trade Union corrected up to date.

(3) A copy of every alteration made in the rules of a registered Trade Union shall be sent to the Registrar within 15 days of the making of the alteration.

7. Certain penalties are provided under Sections 31 and 32 of the Act, for failure to send any notice or return required under the Act and for supplying false information.

CHAPTER 7

OTHER ACTS RELATING TO INDUSTRIES

THE PAYMENT OF WAGES ACT

The Payment of Wages Act (Act IV of 1936) was passed to regulate the payment of wages to certain classes of persons employed in industry. The Act applies to the whole of India except the State of Jammu and Kashmir.

The Act applies (i) to the payment of wages to persons employed in any factory and upon any railway by a railway administration either directly or through a subcontractor, by a person fulfilling a contract with a railway administration, and (ii) to persons earning less than Rs. 200 a month.

The State Government may after giving three months notice, by notification in the Gazette, extend the provisions of the Act or any of them to the payment of wages of any class of persons employed in any industrial establishment or class or group of industrial establishments.

The term factory is used in the Act in the same sense as in the Factories Act. The term 'industrial establishment' means any (a) tramway or motor omnibus services; (b) dock, wharf or jetty; (c) inland steam vessel; (d) mine, quarry or oilfield; (e) plantation; (f) workshop or other establishment in which articles are produced, adapted or manufactured, with a view to their use, transport or sale.

The Payment of Wages. "Wages" means all remuneration, capable of being expressed in terms of money, which would be payable, conditionally or otherwise, to the employed person if the terms of the contract, of employment were fulfilled. Sec. 2 (vi).

The contract of employment may be express or implied. The remuneration payable is called wages even though it is payable conditionally, e.g., upon regular attendance, good work or good conduct.

The term "wages" includes the following:

- (i) bonus or other additional remuneration of the nature aforesaid, and
- (ii) any sum payable to such person by reason of the termination of the employment.

The term "wages" *does not include* the following :

- (a) the value of any house-accommodation, supply of light, water, medical attendance or other amenity, or of any service excluded by general or special order of the State Government ;
- (b) any contribution paid by the employer to any pension fund or provident fund ;
- (c) any travelling allowance or the value of any travelling concession ;
- (d) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment ; or
- (e) any gratuity payable on discharge.

Who is responsible ? The employer is responsible for the payment of wages. In the case of persons employed (otherwise than by a contractor) the following persons are also responsible for the payment of wages : (Sec. 3.)

- (a) the person named as manager in a factory ;
- (b) in industrial establishments the person, if any, who is responsible to the employer for the supervision and control of the establishment ;
- (c) upon railways the person nominated by the railway administration in this behalf for the local area concerned.

Wage periods : The person responsible for the payment of wages shall fix the wage periods in respect of which, wages shall be payable. No wage period shall exceed one month. Sec. 4.

Time of Payment : Section 5 lays down the following rules regarding the time of payment of wages :

(1) In a railway, factory or industrial establishment in which less than 1000 persons are employed, wages must be paid before the expiry of the *seventh* day after the last day of the wage period in respect of which the wages are payable. In all other factories or industrial establishments, wages must be paid before the expiry of the *tenth* day from the last of the wage period as aforesaid.

(2) Where the employment of any person is terminated by or on behalf of the employer, the wages earned by him shall be paid before the expiry of the *second* working day from the day on which his employment is terminated.

(3) The State Government may exempt persons employed in a railway (otherwise than in factory) from the operation of this section, partially or wholly.

- (4) All payment of wages must be made on a working day.

The medium of payment: All wages shall be paid in current coin or currency notes or in both. Sec. 6. By an amendment in Bombay it has been provided that in the case of a bonus which exceeds one-fourth of the annual earnings of the employee, the excess may be paid by bonds or invested.

Deductions from Wages. Section 7 provides that the wages of an employed person shall be paid to him without deductions of any kind *except* those which are authorised by or under this Act. Every payment made by an employed person to his employer or his agent is deemed to be a deduction.

The following deductions are permitted under the Act :

1. *Fines:* Section 8 lays down the following rules regarding fines—

(1) An employed person can be fined only for acts and omissions which are specified in a list which is approved by the State Government or the prescribed authority.

(2) The list must be exhibited in the place of work in the prescribed manner.

(3) Before the fine is imposed on an employed person, he must be given an opportunity of showing cause against the fine.

(4) The total amount of fine which can be imposed on a person in any one wage period must not exceed an amount equal to half an anna in the rupee of the wages payable to him during the wage period.

(5) No fine can be imposed on a person who is below the age of 15.

(6) No fine can be recovered by instalments or after the expiry of 60 days from the day on which it was imposed.

(7) Every fine shall be deemed to have been imposed on the day of the act or omission for which it was imposed.

(8) All fines and the realisations thereof shall be recorded in a register. All such realisations shall be applied only to such purposes beneficial to the persons employed in the factory or establishment as are approved by the prescribed authority. Where the person employed is part of a staff employed under the same management, all such realisations may be credited to a common fund maintained for the staff as a whole. But such a fund can be applied only to the approved purposes.

✓ 2. *Deductions for absence from duty*: Absence from duty means absence from the place where the employed person is required to work. If the employed person, though present at such place, refuse to carry out his work, in pursuance of a stay-in-strike or for any other cause which is not reasonable, he is deemed to be absent from duty.

Deductions from wages are permitted for absence from duty. Section 9 provides that the ratio between the amount of such deduction and the wages payable must not exceed the ratio between the period of absence and the wage-period. It is, however, provided that (subject to any rules made in this behalf by the State Government) if ten or more employed persons acting in concert absent themselves without due notice and without reasonable cause, such deduction from any such person may include such amount (not exceeding his wages for eight days) as may be due to the employer in lieu of notice.

3. *Deductions for damage or loss*: Deductions from wages are permitted for damage to or loss of goods expressly entrusted to the employed person for custody, or for loss of money for which he is required to account, where such damage or loss is directly attributable to his neglect or default. Section 10 provides that a deduction under this rule shall not exceed the amount of damage or loss caused to the employer by the neglect or default of the employed person. Also, before the deduction is made, the employed person must be given an opportunity of showing cause against the deduction and the procedure prescribed for making the deduction must be followed. All reductions and the realisations thereof must be recorded in a register.

4. *Deductions for services rendered*: Deductions are permitted for house-accommodation supplied by the employer and for such amenities and services as the State Government may, by general or special order, authorise. The word 'service' does not include the supply of tools and raw materials required for the purposes of employment. Section 11 provides that deductions for services of the aforesaid character can be made only if the services are accepted by the employed person as a term of service or otherwise. Deductions must not exceed the value of the accommodation or other service. As regards services other than house-accommodation, the State Government may impose conditions.

5. *Advances and overpayments of wages*: Deductions are permitted for recovery of advances or for adjustments of overpayments of wages. Section 12 provides that (a) recovery of an advance of

money given before employment began shall be made from the first payment of wages in respect of a complete wage-period, but no recovery shall be made of such advances given for travelling-expenses; and (b) recovery of advances of wages not already earned shall be subject to any rules made by the State Government regulating the extent to which such advances may be given and the instalments by which they may be recovered.

6. *Income Tax payable by the employed person*: The employer is permitted to deduct income tax payable by an employed person.

7. *Orders of Court*: If any deduction is directed by the Court (e.g., in execution of a decree against the employed person) it must be done.

8. *Provident Funds*: Deductions may be made of the contributions payable by the employed person to the provident fund.

9. *Co-operative Societies and Insurance Schemes*: Deductions may be made for payments to co-operative societies approved by the State Government or to a scheme of insurance maintained by the Indian Post Office. The State Government may impose conditions upon such deductions.

10. *Deductions with written authorisation of the employed person*: Deductions may be made with the written authorisation of the employed person, in furtherance of any War Savings Scheme approved by the State Government, the purchase of securities of the Government of India or the Government of the United Kingdom.

Enforcement of the Act. Inspectors may be appointed for the purpose of examining records and documents relating to the payment of wages and to do other work necessary for carrying out the purposes of the Act. Inspectors of Factories, appointed under the Factories Act, are inspectors for the purposes of this Act. Sec. 14.

The State Government may appoint any Commissioner for Workmen's Compensation, or any officer having experience as judge or magistrate, as the authority to hear and decide all claims arising out of deductions from wages or delay in payment of wages. An application before such authority may be filed by the person concerned or any legal practitioner or official of a registered trade union authorised by him in writing or any inspector under this Act or any other person with the permission of the authority appointed as aforesaid. The application shall be presented within six months of the date of deduction or the date when the payment of wages was due. It may be filed later if the authority is satisfied that there was sufficient cause. The

authority is to enquire into the matter, giving an opportunity to the employer of being heard. The authority may direct refund of deduction or payment of the delayed wages, together with such compensation as he may think fit, not exceeding ten times the deduction in cases of improper deductions and Rs. 10 in cases of delayed wages. No compensation is to be given in cases of *bona fide* error or dispute, the occurrence of an emergency or the existence of exceptional circumstances or the failure of the employed person to apply for or accept payment. If the authority considers that any application is malicious or vexatious, he may direct that a penalty not exceeding Rs. 50 shall be paid to the employer by the person presenting the application. The penalty will be realised as if it was a fine imposed by a magistrate. Sec. 15.

An application under Section 15 may be presented by a number of persons together if they belong to the same unpaid group. Sec. 16.

From the orders of the authority appointed under Section 15 an appeal may be preferred within 30 days to the Court of Small Causes in Presidency Towns and the District Court in other cases. An appeal lies (a) by the employer if the total sum payable exceeds Rs. 300 (b) by the employed person if the total wages withheld exceeds Rs. 50 and (c) by any person directed to pay a penalty. In all other cases the direction of the authority is final. Sec. 17.

Persons violating the provisions of Sections 5 & 7 to 13 can be fined up to Rs. 500. Persons violating the provisions of Sections 4, 6 and 25 can be fined up to Rs. 200. Sec. 20.

No Court shall entertain any suit for the recovery of wages or deductions from wages if the matter is pending or has been decided under Section 15 or 17 or could have been recovered by an application under Section 15. Sec. 22.

Any contract, whereby an employed person relinquishes any right conferred by this Act, shall be null and void in so far as it purports to deprive him of such right. Sec. 23.

The person responsible for the payment of wages in a factory shall cause to be displayed in such factory a notice containing an abstract of the Act and the rules framed under it, in English and in the language of the majority of the persons employed in it. Sec. 25.

THE MINIMUM WAGES ACT

The Minimum Wages Act (Act XI of 1948) provides for fixing minimum rates of wages in certain employments. The Act extends to the whole of India except the State of Jammu and Kashmir. Definitions of certain terms used in the Act are given below.

Appropriate Government: The Central Government is the appropriate Government in relation to any scheduled employment carried on by or under the authority of the Central Government, by a railway administration, or in relation to a mine, oilfield, or major port, or any corporation established by a Central Act. The State Government is the appropriate Government in all other cases.

Scheduled Employment: These are employments specified in the schedule to the Act. The Schedule is divided into two parts. The appropriate Government can add to the schedule.

Cost of Living Index Numbers: The appropriate Government can appoint a competent authority to ascertain from time to time the cost of living index number applicable to the employees employed in the scheduled employments. The Index Numbers are notified in the official Gazette. Sec. 2 (c) & (d).

Wages: The definition given is identical with that given in the Payment of Wages Act. Sec. 2 (h).

Employer: This term means any person who employs, either directly or through any other person, or whether on behalf of himself or any other person, one or more employees in a scheduled employment where minimum wages have been fixed. The term includes the manager of a factory and other persons in the same position. Sec. 2 (e).

Employee: This term means any person who is employed for hire or reward to do any work, skilled or unskilled, manual or clerical, in a scheduled employment in respect of which minimum rates of wages have been fixed. The term includes a worker who works outside the factory with materials supplied by the employer. Sec. 2 (i).

Fixation of Minimum Rates of Wages. Section 3 provides that the appropriate Government shall fix the minimum rates of wages payable to the employees of scheduled employments within the dates laid down in the Act. (The dates have been extended by later amendments.) The minimum rates may be fixed for the whole State or for a part of the State or for a specified class of employment. The rates may be reviewed at intervals, not exceeding five years. If in any scheduled employment, less than 1000 workers are employed, minimum rates need not be fixed until the number reaches 1000. Minimum rates may be fixed for time-work, piece-work and overtime work, and a minimum rate of remuneration to apply in the case of employees employed on piece work for the purpose of securing to such employees a minimum rate of wages on a time-work basis. The last mentioned rate is called "a guaranteed time-rate."

Different rates of wages may be fixed for different scheduled employments ; different classes of work in the same scheduled employment ; adults, adolescents, children and apprentices ; and, different localities.

Minimum rates of wages may be fixed by the hour, by the day or by any larger wage-period. Provided where any wage periods have been fixed under Section 4 of the Payment of Wages Act, minimum wages shall be fixed in accordance therewith.

Section 4 provides that any minimum rate of wages fixed or revised by the appropriate Government may consist of the following :

- (i) a basic rate of wages together with a cost of living allowance to be adjusted in accordance with the variations in the cost of living index number ; or
- (ii) a basic rate of wages with or without the cost of living allowance and the cash value of concessions in respect of supplies of essential commodities where authorised ; or
- (iii) an all-inclusive rate allowing for the basic rate, the cost of living allowance and the cash value of concessions, if any.

Procedure for fixing minimum wages : For fixing minimum wages, the appropriate Government shall either (a) appoint a committee (with sub-committees for different localities) or (b) by a notification in the official Gazette publish its proposals and specify a date, not less than two months from the date of the notification, on which the proposals will be taken into consideration.

After considering the advice of the committee in case (a) and the representations received from the parties interested in case (b), the appropriate Government shall fix the minimum rates by notification in the official Gazette. Unless otherwise provided, the rates shall come into force on the expiry of three months from the date of the notification. Sec. 5.

For the purpose of revising the minimum rates of wages, the appropriate Government may appoint Advisory Committees and Sub-committees. To co-ordinate the work of the Committee, there may be an Advisory Board. The Central Government shall appoint a Central Advisory Board for the purpose of advising the Central and the State Governments and for co-ordinating the work of the Advisory Boards. The members of the Committees and Boards shall be nominated by the appropriate Government. Each shall consist of an equal number of representatives of employers and employees and independent persons not exceeding one-third of the total number of members. The Committees and Boards are to be consulted before revising the

minimum rates. Revisions of rates are to be notified in the official Gazette. Unless otherwise provided, the revisions come into force on the expiry of three months from the date of issue of the Gazette. Section 5 to 10.

Payment of minimum wages: Where minimum wages have been fixed as provided above, the employer shall pay wages at a rate not less than the minimum fixed for every category of employees without any deductions except such as may be authorised.* The provisions of the Payment of Wages Act are not to be affected. Sec. 12.

Minimum wages payable under the Act shall be paid in cash. But where it is customary to pay wages wholly or partly in kind, the appropriate Government may authorise such payment. It may also authorise the supply of commodities at concession rates. The cash value of such concessions and of wages in kind shall be estimated in the prescribed manner. Sec. 11.

Normal Working Day: In a scheduled employment where minimum wages have been fixed, the appropriate Government may fix the number of hours of work which shall constitute a normal working day, inclusive of one or more specified intervals. It may also provide for a day of rest in every period of seven days and for the payment of remuneration in respect of such days. Sec. 13.

An employee working less than the normal working day is entitled to receive wages for the full working day except in the following cases (i) where his failure to work is caused by his unwillingness to work and not by the omission of the employer to provide him with work, and (ii) in such other cases and circumstances as may be prescribed. Sec. 15.

Overtime: For every hour or part of an hour worked in excess of the normal working day, the employee is entitled to receive remuneration at the rates fixed for overtime work under this Act or under any law of the appropriate Government in force, whichever is higher. Sec. 14.

Two or more classes of work: Where an employee does two or more classes of work to each of which a different minimum rate is applicable, the employer shall pay for each such class of work wages at rates not less than the minimum rate in force in respect of each such class. Sec. 16.

Enforcement of the Act. Every employer shall keep registers and records showing particulars of workers employed, work performed by them, wages paid, etc. The minimum rates of wages and certain other particulars are to be exhibited at the place of work for the

information of the employees. Rules may be framed for the issue of wage books or wage slips to the workers. Sec. 18.

The appropriate Government may appoint Inspectors for the purposes of this Act. The functions of the Inspectors are analogous to those of Inspectors appointed under the Payment of Wages Act. Sec. 19.

Sections 20 and 21 provide for the hearing of claims under this Act by qualified authorities. The procedure for dealing with the claims and the powers and functions of the authorities are more or less the same as those under the corresponding sections of the Payment of Wages Act.

Section 22 provides for penalties for violating the provisions of the Act. An employer who pays less than the prescribed minimum wage or infringe any order or rule made under Section 13, may be punished with imprisonment of either description up to six months and/or fined up to Rs. 500. The section also lays down the procedure for taking cognisance of offences under the Act and or holding trials for the same.

Section 23 provides that an employer will be excused from liability if he can show that some other person was responsible for the offence and (a) that he has used due diligence to enforce the execution of the Act, and (b) that the said other person committed the offence in question without his knowledge, consent or connivance. The other shall in such cases be liable to punishment.

Section 24 provides that no court shall entertain any suit for the recovery of wages in so far as the sum so claimed has been dealt with under Section 20 of the Act or might have been recovered under that section.

Section 25 provides that any contract whereby an employee either relinquishes or reduces his right to a minimum rate of wages or any privilege or concession accruing to him under the Act shall be null and void in so far as it purports to reduce the minimum rate of wages fixed under this Act.

The following exemptions and exceptions are allowed under Section 26.

(1) The provisions of the Act shall not apply to disabled employees if the appropriate Government so declares.

(2) Specified employments may be exempted from all or some of the provisions of the Act by the appropriate Government.

(3) Nothing in the Act shall apply to the wages payable by an employer to a member of his family who is living with him and is dependent on him. Member of the family of an employer shall be

deemed to include his or her spouse or child or parent or brother or sister.

The Central Government can give directions to a State Government as to the carrying into execution of this Act in the State. Sec. 28.

The Central and the State Governments have been given power to frame rules under the Act.

ACTS RELATING TO MINE-WORKERS

There are several Acts relating to mine-workers. *The Mines Act* (Act XXXV of 1952) amends and consolidates the law relating to the regulation of labour and safety in mines. *The Mines Maternity Benefit Act* (Act XIX of 1941) regulates the employment of women in mines for a certain period before and after childbirth and provides for the payment of maternity benefit to them. *The Mica Mines Labour Welfare Fund Act* (Act XXII of 1946) provides for the constitution of a fund for the financing of activities to promote the welfare of labour employed in the mica mining industry. *The Coal Mines Labour Welfare Fund Act* (Act XXII of 1947) makes similar provisions for coal mine workers. *The Coal Mines Provident Fund and Bonus Schemes Act* (Act XLVI of 1948) provides for the framing of a Provident Fund Scheme and a Bonus Scheme for persons employed in coal mines.

CHILD-LABOUR

Rules regarding child-labour are contained in the Factories Act, Mines Act etc. There are also two general Acts on the subject. *The Children (Pledging of Labour) Act* (Act II of 1933) prohibits the making of agreements to pledge the labour of children and the employment of children whose labour has been pledged. *The Employment of Children Act* (Act XXVI of 1938) prohibits the employment of a child who has not completed his fifteenth year of age in any occupation connected with the transport of passengers, goods or mails by railway or connected with a port authority within the limits of any port. The Act also prohibits the employment of a child, who has not completed his fourteenth year of age, in the processes set forth in the schedule to the Act. Children between 15 and 17 can be employed subject to certain restrictions as regards their periods of rest etc.

ACTS RELATING TO PARTICULAR OCCUPATIONS

There are several Acts relating to particular occupations. They lay down rules regarding hours of work, conditions of employment etc. in those occupations.

Railway workers—*The Indian Railways Act (Act IX of 1890)*—Sections 71A to 71H.

Dock workers—*The Indian Dock Labourers Act (Act XIX of 1934)* and *Dock Workers (Regulation of Employment) Act (Act IX of 1948)*.

Plantation workers—*The Plantations Labour Act (Act LXIX of 1951)*.

Journalists—*The Working Journalists (Conditions of Service) and Miscellaneous Provisions Act (Act XLV of 1955)*.

WEEKLY HOLIDAYS

The Weekly Holidays Act (Act XVIII of 1942) provides for the grant of weekly holidays to persons employed in shops, restaurants and theatres. The Act can be applied to a State by notification of the State Government.

STANDING ORDERS

The Industrial Employment (Standing Orders) Act (Act XX of 1946) requires employers in industrial establishments formally to define and put down in writing the conditions of employment of the workers employed by them.

PROVIDENT FUND

The Employees Provident Funds Act (Act XIX of 1952) provides for the institution of provident funds for employees in factories and other establishments.

STATE LEGISLATION ON LABOUR

The States in India possess power to pass laws relating to labour. A large number of such Acts have been passed, e.g. Maternity Benefit Acts have been passed in almost all States. Laws have been passed in Bombay regarding industrial disputes. There may be local amendments to Central Acts. For example, the Payment of Wages Act has been modified in certain respects by several States. Many States have passed laws for the regulation of work in shops and commercial establishments.

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